TRENDS OF FOREIGN DIRECT INVESTMENT IN SELECTED ASIAN COUNTRIES DURING 1990's WITH SPECIAL REFERENCE TO INDIA

ABSTRACT

THESIS

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BY

MD QAISER ALAM

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PROF. MASOOD HASAN

DEPARTMENT OF ECONOMICS
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ABSTRACT

The present study on "Trends of Foreign Direct Investment in selected Asian countries during 1990's with special reference to India" has some special significance. Although, a considerable body of literature is available, there remains a considerable scope for fresh additions to this seminal topic, as it is tremendously relevant to modern economic study. It not only attracts academicians and policy makers but also holds a great deal of interest for the general public. I have selected this topic keeping these factors in view and have gone for a comparative analysis with emphasis on socio - economic and policy factors. FDI along with GDP, GNP per capita, import, export, gross domestic saving, gross domestic capital formation, gross fixed capital formation and inflation in a set of countries are a subject of study.

FDI is defined as foreign investment by institutions, entrepreneurs, corporate undertakings and transnational corporations in productive units and in the developmental activities. This is not only in the form of financial capital but also in the form of technological, managerial and intellectual capital that jointly represents a stock of assets. It is defined as an investment made by MNCs in order to earn private return. The investing units have a power to exert control over decision making process of the investing unit. It has a special meaning in that it refers to the flows of equity capital into a subsidiary where the foreign investors (or TNCs) have a controlling interest. However, FDI flows differ from Portfolio

investment. Where the former is considered as long-term investment, and the latter is typically guided by short term consideration of speculative gains.

Moreover, FDI flows involve control by foreign investors and "long term" considerations. In short, FDI flows comprises two distinct forms namely, equity and non-equity form of investment. The equity capital comprises of the FDI purchase of shares of an enterprise; FDI shares in reinvested earnings; and short or long term intra-company loans or debt transactions between FDI and the affiliates. The non-equity form of FDI includes investments through such activities as sub-contracting, management contracts, turnkey projects, franchising, licensing and product sharing contracts etc.

FDI is a large and growing source of equity investment that brings with it considerable benefits such as technology transfer, management, know-how and export marketing access etc. It contributes to the growth of developing economies through various channels in addition to the physical capital formation, including technology transfer, human capital (management skills) development and promotion of foreign trade. It boosts trade, income, output and employment in the host country by providing a stimulus to the production of locally produced inputs as well as to competition, innovation, savings and capital formation. It is superior to other form of foreign capital namely, FIIs, commercial loans, foreign aid etc. It supplements a country's purchasing power by the supply of potential savings, avoids inflationary pressures and also overcomes high interest rates and high cost of debt

servicing. It is accompanied by low cost and market accessibility and promotes export qualities. The additional benefits of FDI flows are that it brings a superior technology in the country. It increases competition by setting up firms in the economy and producing the goods at cheaper cost and expands the industrial base in the country. The foreign owned firms stimulate local productivity through backward linkages with service supplies and the labour force, and by serving as a model of efficient working practices and management techniques.

The effectiveness of the FDI flows depends upon its meaningful use and their purposes, which require to focus the existing areas in which the injection of capital and know-how becomes fruitful from the developmental point of view. FDI related with export-oriented areas especially in medium and long-term investment projects fulfills the developmental needs of the country. This gives a boost to the better utilization of existing natural resources, manpower and creates an atmosphere conducive to providing efficient and cheap availability of goods and services.

MNCs not only provide financial resources, but they also provide needed resources such as managerial expertise, entrepreneurial abilities and technological skills by means of training programmes etc. They also educate local managers about how to establish contracts with overseas banks, diversify market outlets and become better acquainted with international marketing practices. Moreover, it brings the most sophisticated technological knowledge about production

process along with financial resources, while transferring modern machinery and equipment to capital poor third world countries, which is assured to be both desirable and productive for the respective countries.

LITERATURE REVIEW

The literature on foreign direct investment is massive and this section presents a brief introduction about the pioneering works carried out by eminent economist and national as well as international organizations.

In the past there have been substantial work studying the effects of direct foreign investments on the Newly Industrialized Economies (NIEs) and ASEAN-4 economies viz, Galenson, 1985; UN, 1985; Nayavichit Vadakan and Kerdepule, 1987. The effects of USA domestic foreign investment abroad have been studied in (Bergeston, Horst and Moran, 1978; Lipsey and Weires, 1981,1984; Bolmston, Lipsey and Kulchycky, 1988. There are few studies of Japanese domestic foreign investment abroad effecting Japanese economy (Goto, 1988).[25]

Among the factors that determine the distribution of FDI flows across developing countries includes among others Per capita income, growth rate, extent of urbanization, availability of infrastructure, political uncertainty and BOP position (Root and Ahmed, 1979; Scheneider and Frey, 1985). A study on direct foreign investment for the period 1964 to 1970 found that the net economic benefits of such investment was negative as it proved to be an expensive form of borrowing and their

contribution to external trade was also found to be negligible (Kelkar, 1984).

DR. J.H. Dunning has analysed the capacity of the developing nations to absorb investment. The population and the level of skills in a country are the important determinant of the capacity of an economy to absorb foreign direct investment. According to a study, direct investment seems to be positively related to the level of market size and its underlying growth, but does seem to react systematically to short term change in rates of market growth (Pierce, 1991). Once a market attains a size that permits the local production to realize effectively economies of scale, the level of foreign direct investment in that market is linked closely to its size. Regulations in areas such as remittances, price controls and investment do not seem as influential on investment decision as economic factors.

In an empirical study on liberalization as determinants of FDI regarding 46 countries found no significant relation. It was found that the FDI flows are strongly influenced by the size and growth of the host economy rather than by changes in the government FDI policies (Contractor, 1990).

Similarly, another related study covering the period 1982-1998 noticed the importance of the quality of infrastructure, level of Industrialization and market size in attracting American FDI. It was also found that FDI incentives were found to be of limited importance in determining the investment decisions (Welers and Mody, 1992).

A study analyzing the impact of MNCs on growth observed that such corporations have made significant positive contribution in the growth of capital formation and transfer of technology in the developing countries. It has also noticed improved export performance because of shift of exports to technologically advanced products (UNCTAD, 1992).

Shen Xiao Fang, on the first decade of China's experience with FDI, emphasized that in spite of the difficulties and set back, initial FDI performance made a significant contribution to the Chinese economy during this period and FDI had already reached a critical stage in which fundamental socio-economic problems were destined to hinder its further development.

A survey of literature on FDI in developing countries has studied technology spillovers from FDI in Indian manufacturing firm empirically and has found significant indirect benefits from FDI (De Mello, 1997 and Kathuria, 1998). A study done by Golberman and Others on the issue of the effects of policy changes on inward and outward FDI found that the free trade agreements had positive effects, whereas the screening of the projects has no significant effect on the FDI. Another related study on the issues of effects of capital controls on the volume and composition of the capital flows concludes that the capital controls influence the composition of flows, but sterilized intervention influences both volume and composition of FDI flows (Monteil and Reinhart, 1999).

The numerous studies on the relationship between the FDI and country risk have pointed out that there exists a significant relationship between FDI and country economic and political risk (Lehman, 1999, Ramcharran, 1999, and Pistoresi, 2000). The other studies on the relationship between FDI and regulatory changes in Asian countries have found that there exists a significant correlation between reform expectations and FDI flows (Thompson and Poon, 2000). A study on the location as a determinant of FDI has pointed out regional market size, good infrastructure and preferential tax policies effects positively whereas the wage cost effect negatively (Cheng and Kwan, 2000). The study related to export and FDI by Donnefield and Weber (2000), taxes and FDI by Wei (2000), FDI and Exchange rate votality Sung and Lapon (2000) and Moshirian (2001), on FDI and banking pointed out that the major determinates are bilateral trade, banks foreign assets, costs of capital and exchange rates. A more recent study on the effects of liberalization on FDI flows pointed out that the policy changes are more important for FDI than GDP growth rate or exchange rate (Sin and Lung, 2001).

RESEARCH METHODOLOGY

The statistical data can be collected from Primary sources and Secondary sources. The primary sources include the data collected from the person concerned directly or indirectly through questionnaires. The secondary sources include published and unpublished data collected from

different agencies and government offices, which is used for further studies.

The study has relied extensively on published accounts, reports and proceedings of national as well as international organizations. The secondary sources include the data collected from the publications of World Bank, Asian Development Bank, United Nations, UNCTAD, NCAER, IMF, OECD, MOFTEC, MIDA, EDB, RBI, IIFT and India's Investment Center. The perception of the problem is portrayed in the study with the help of economic principles and statistical techniques.

A simple and basic statistical analysis like, Minimum Value, Maximum value, Mean, Standard Deviation, Coefficient of Variation and Correlation Coefficient is carried out primarily with the help of Secondary data available from various sources for the period 1990-2001.

Growth rates of FDI in selected Asian countries namely China, Indonesia, Thailand, Singapore, Malaysia and India have been calculated by taking time as independent variable and rest of the variables (Country-wise and Sector-wise break-up of FDI) as dependent variable.

The equation for the calculation of the growth rates is the well known compound interest formula as follows,

$Y_t = Y_o + (1+r)^t$ ----------(1)

Where Y_t is real growth rate at time t and Y_o is the initial (i.e 1990) value of FDI flows and " r " is the compound (i.e., over time) rate of growth of Y

Talking the Natural Logarithm of the equation —(1)

$$\text{Ln } Y_t = \text{Ln } Y_0 + t \text{ Ln } (1+r) \text{----------(2)}$$

Putting $\beta_1 = \text{Ln } Y_o$ and $\beta_2 = \text{Ln } (1+r)$ in equation (2), Now can be Written as,

$$\text{Ln } Y_t = \beta_1 + \beta_2 t \text{----------(3)}$$

Equation (3) shows that regressand is the Logarithm of Y_t and the regressor is 'time' and the percentage compound rate of growth is calculated by taking antilog of regression coefficients, subtracting "1" from it and multiplying the difference by 100.

The study is planned in different chapters as follows. ***Chapter-1:*** It is the introduction of the study. It goes into the background of the concepts related to foreign direct investment. It discusses the various theories of foreign direct investment. It highlights the importance, objectives of the study, available work on foreign direct investment and planning of the research work. ***Chapter-2:*** It deals with the role of foreign direct investment in developing economies. It provides an eye view of the socio-economic aspects of foreign direct investment flows in the developing economies. It goes into the details of the impact of foreign direct investment flows on the developing economies. ***Chapter-3:*** It presents the separate study of the foreign direct investment scenario in selected Asian countries namely China, Indonesia, Thailand, Singapore and Malaysia. It deals with the respective government policy framework associated with foreign direct investment flows. ***Chapter-4:*** It comes up with the foreign direct investment scenario in the Indian economy. It covers both the pre-reform and post-reform period policy framework

along with foreign direct investment flows. It also deals with the hurdles in the way of smooth flows of foreign direct investment along with suitable suggestions. ***Chapter-5:*** It gives an account of the various determinants of foreign direct investment along with regulatory framework in selected Asian countries. It presents the comparative analysis of the foreign direct investment trends in top ten Asian countries along with a model, analyzing the relationship between foreign direct investment and various macroeconomic variables. ***Chapter-6:*** It sums up the study with a conclusions and suitable suggestions.

RESULTS OF THE STUDY

FDI has played a significant role in the growth and development of the world economy particularly the developing countries. It has enabled these countries especially some of the South-East and ASEAN countries to realize a high growth rate of income, output and employment of their economies. These prospects have brought the more liberal policy framework, a host of incentives with several bilateral and multilateral treaty agreements among these countries. Especially, the 1990s pervasive phenomena of liberalization, privatization and globalization have influenced a large number of developing countries to liberalise their FDI policies. FDI Polices along with trade polices have infact become the focus of liberalization efforts in almost every country.

The distribution of FDI flows to developing countries and economies in transition has been quite uneven. The

developing Asian region is the most important in terms of FDI, having over taken Latin American and the Caribbean economies. The recent investment flow figures show that the region is further building its lead. This is reflected by the developing Asia's continued performances, growing market size, profitable investment opportunities among the developing country regions in terms of GDP, export growth rates as well as the ability to control and manage indebtedness. This also includes the fiscal adjustment programmes, declining fiscal deficits, trade liberalization and financial sector liberalization, which have promoted more private sector activity and outward oriented economies. This has made developing Asia particularly the East and South-East Asian region as the largest recipient of FDI among the developing countries, whereas the substantial part of the FDI inflows are interregional. The concentration of FDI flows in these countries has resulted also due to (a) minimum risk and better prospects in these countries (b) low production costs associated with higher productivity (c) the appreciation of other respective currencies (d) infrastructure improvements and technology upgradation in ASEAN countries and (e) market externalities in other developing countries and market growth realized by the several countries of the region. Moreover, the opening up of certain sectors, particularly in services and the relaxation of rules concerning ownership mode of entry and financing, together with the long-term prospects of these economies contributes to these flows. The inflows of FDI to the developing countries in 2001 was US

$204801 million in which US $10266 million (27.9 per cent) went to developing Asia, and where US $46840 million gone to China alone. Latin America and the Caribbean received US $85373 million (11.6 per cent) in the year 2001. The countries of the Central and Eastern Europe still in transition to a market economy attracted US $27200 million (merely 3.7 per cent) of the total FDI flows in the year 2001.

Asian economies are among the fastest growing economies in the world, which is reflected from the realization of sound macroeconomic variables. FDI has played a major role in the development of these economies. Among these countries South-East Asia and the ASEAN countries have realized a high growth rate of their economies.

The share of Asian developing countries in attracting FDI flows in the world economy has increased but its share in developing countries has been decreased. Among the South - East Asian economies, FDI have sharply declined for Indonesia, and Malaysia has also experienced a downward trend. The Republic of Korea too has experienced a decline in the volume of FDI flows.

FDI flows in Asia have shifted from NIEs to ASEAN and further to China due to rising wages and currency appreciation in other countries. FDI flows in the Asia and the pacific is characterized by a decline in interregional investment, due to the financial and other difficulties faced by the regions TNCs. There is an increasing tendency of liberalization in some countries in order to have more investment flows. The tax incentives in China, Indonesia,

Malaysia and Singapore consist of free import of capital equipment, tax holidays, accelerated depreciation, investment allowance, exemption from withholding taxes on dividends and interests rates etc. The vehicle for industrial restructuring in these countries has been FDI, where TNCs have played as a catalyst for industrial restructuring and competitive regimes in the region.

FDI flows seem to be depending on the sound infrastructural facilities as in the Guandong province of China, Judong in Singapore, and the Penang Peninsula in Malaysia. China's success in attracting large FDI flow also depends on the greater degree of decentralization of powers in the hands of the local authorities, whereas the centralized decision-making process in India creates cumbersome bureaucratic delays in the process of approval of FDI.

A common characteristic of the foreign investment policy of the countries studied is a remarkable degree of continuity. The existence of sound infrastructure facilities and favourable labour laws are the critical determinants of FDI flows into these countries. The activities of TNCs have been concentrated in a handful of host countries, namely the NIEs, a few countries in South – East Asia (Indonesia, Malaysia, Philippines and Thailand) and China, which altogether have attracted the bulk of FDI flows.

However, the effects of FDI flows on various macroeconomic variables have been found to be varying from country to country. For China, gross fixed capital formation is the major factor influenced by FDI flows, followed by gross

domestic capital formation and gross domestic saving. Similarly, the gross domestic capital formation along with gross domestic saving is found to be affected respectively by FDI flows in Indonesia. In Singapore, GNP per capita with gross fixed capital formation and gross domestic saving is the major factor respectively influenced by FDI flows. For Malaysia, gross domestic capital formation with gross fixed capital formation and GNP per capita, respectively have been strongly related with FDI flows. Export along with GNP per capita and gross fixed capital formation is found to be closely related with FDI flows in India.

Thus, Asian countries have realized a boom in the growth of investment, production and trade over the past few years and even there a double digit growth in China, parts of ASEAN and the Republic of Korea. This has resulted from an increased regionalization or globalization of production and the liberalization of investment and trade regimes within a framework of market oriented private sector growth. Japan, NIEs of Asia, Hong-Kong, Republic of Korea, Singapore, Taiwan and the ASEAN-4 (Indonesia, Malaysia, Philippines and Thailand), have realized a rapid economic growth. The high economic growth in these economies have been characterized by changes in the structure of economic activity with manufacturing industries in particular becoming more important and the migration of production lines towards developing Asia. FDI by multinationals from USA, Japan, Europe and recently by the Asian NIEs and ASEAN-4

economies have played a crucial role in stimulating these growths.

FDI has played a significant role in promoting the economic growth of East and South-East Asian economies, through cost reduction and export promotion and by economic transformation of South-East Asian economies. Although, for some economists the role of FDI in economic development is still doubtful, but it can be said that if, foreign capital is properly utilized can contribute significantly to economic development. This can be reflected from the growth performance of the South-East Asian economies, which are acknowledged to have absorbed a significant amount of FDI, though the primary growth impetus may have come from domestic efforts. Lastly, it may be said that the success of these countries in attracting FDI flows was in large part to the command nature of these countries, particularly in Singapore and China, which allowed for quick changes in laws in responses to the emerging needs. This was also true for Malaysia, whereas in India, the ability to effect similar changes are limited.

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ALIGARH MUSLIM UNIVERSITY
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TO WHOM IT MAY CONCERN

This is to certify that the thesis entitled ***"Trends of Foreign Direct Investment in Selected Asian Countries during 1990's with special reference to India "*** is the original work of **Md. Qaiser Alam** under my supervision and is suitable for submission for the award of Ph.D. degree in Economics.

(Prof. Masood Hasan)

Supervisor

DEDICATED

TO

MY BELOVED

PARENTS

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PREFACE

FDI is defined as foreign investment by institutions, entrepreneurs, corporate undertakings and transnational corporations both in the form of financial capital as well as in physical capital. Such a type of capital exerts a power to control by foreign investors and of "long term" considerations. Thus, it gives a stake in the future economic development of the country. FDI flows comprises FDI purchase of shares of an enterprise, FDI shares in reinvested earnings, short or long term intra-company loans or debt transactions between FDI and the affiliates, sub-contracting, management contracts, turnkey projects, franchising, licensing and product sharing contracts etc. Moreover, it not only includes financial resources but also entails the flows of managerial expertise, entrepreneurial abilities and technological skills.

It supplements a country's purchasing power by the supply of potential savings, avoids inflationary pressures and also overcomes high interest rates and high cost of debt servicing. It is accompanied by low cost and market accessibility and promotes export qualities.

FDI flows boost to the better utilization of existing natural resources, manpower and creates an atmosphere conducive to providing efficient and cheap availability of goods and services. It also boosts trade, income, output and employment in the host country by providing stimulus to the production of locally produced inputs as well as to competition, innovation, savings and capital formation.

The foreign owned firms stimulate local productivity through backward linkages with service supplies and the labour force, and by serving as a model of efficient working practices and management techniques. It brings the most sophisticated technological knowledge about production process along with financial resources, which is assured to be both desirable and productive for the respective countries.

FDI has played a significant role in the development of developing economies. This includes most of the countries in South-East Asia and the ASEAN countries, which have realized a high growth rate of income, output and employment of their economies.

With this background, this study has made an attempt to have a comparative analysis of the FDI flows in selected Asian countries and to evaluate the factors causing FDI flows in these countries. I have gone for a comparative analysis with an emphasis on socio - economic and policy factors. FDI along with GDP, GNP per capita, import, export, gross domestic saving, gross domestic capital formation, gross fixed capital formation and inflation in a set of countries are a subject of study.

MD QAISER ALAM

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ABBREVIATIONS

ADB	Asian Development Bank
ASEAN	Association of South East Asian Nations
ASP	Approved Service Project
BIPPT	Bilateral Investment Promotion and Protection Treaties
$BOP_{(s)}$	Balance Of $Payment_{(s)}$
CCEA	Cabinet Committee on Economic Affairs
DDT	Double Taxation Treaties
EDB	Economic Development Board
EEIA	Economic Expansion Incentives Act
$EOU_{(s)}$	Export Oriented $Unit_{(s)}$
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act
FERA	Foreign Exchange Regulation Act
$FII_{(s)}$	Foreign Institutional $Investor_{(s)}$
FIIA	Foreign Investment Implementation Authority
FIPB	Foreign Investment Promotion Board
$FTZ_{(s)}$	Free Trade $Zone_{(s)}$
GDP	Gross Domestic Product
GNP	Gross National Product
GPCS	Global Personal Communication by Satellite
IAS	Innovators Assistance Scheme
IFC	International Financial Statistics
IIC	India's Investment Center
IIFT	Indian Institute of Foreign Trade
IOFC	International Offshore Financial Center
IOC	Indian Oil Corporation

IMF	International Monetary Fund
ITA	Investment Tax Allowance
JETRO	Japan Exterior Trade Research Organisation
LERMS	Liberalized Exchange Rate Management System
MAI	Multilateral Agreement on Investment
MADAS	Manpower Development Assistance Scheme
MIDA	Ministry of Industrial Development Authority
MIGA	Multilateral Investment Guarantee Agency
MITI	Ministry of International Trade and Industry
$MNC_{(s)}$	$Multinational\ Corporation_{(s)}$
$MNE_{(s)}$	$Multinational\ Enterprise_{(s)}$
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
MRTP	Monopolistic and Restrictive Trade Practices Act
M&A	Merger and Acquisitions
NAFTA	North Atlantic Free Trade Agreement
$NBFC_{(s)}$	$Non\ Banking\ Financial\ Companie_{(s)}$
NCAER	National Council of Applied Economic Research
NEP	New Economic Policy
$NIE_{(s)}$	$Newly\ Industrialized\ Economie_{(s)}$
$NRI_{(s)}$	$Non\ Resident\ Indian_{(s)}$
$OCB_{(s)}$	$Overseas\ Corporate\ Bodie_{(s)}$
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
OGL	Open General License
ONGC	Oil and Natural Gas Commission
PAF	Patent Application Fund
PIO	Persons of Indian Origin

PMA	Penanaman Model Asing
RBI	Reserve Bank of India
RDAS	Research and Development Assistance Scheme
RIB	Resurgent Indian Bond
R&D	Research and Development
SBI	State Bank of India
SEBI	Securities and Exchange Board of India
$SEZ_{(s)}$	Special Economic $Zone_{(s)}$
TDS	Technical Development Fund
$TNC_{(s)}$	Transnational $Corporations_{(s)}$
$TRIP_{(s)}$	Trade Related Intellectual Property $Right_{(s)}$
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
WIR	World Investment Report
WTO	World Trade Organization

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CHAPTER-1

Chapter-1

CONCEPTUAL FRAMEWORK AND BASIC ISSUES

1.1 INTRODUCTION

Asia is the largest continent in the world. It is large specifically in the geographic and demographic spheres and it has yet to realize its full potential in the economic sphere. Many countries in the continent have a long way to go in providing even the basic amenities of life to their people. Despite, the glory and grandeur of the past, it is presently marked by poverty and deprivation.

In the early stages of development, relatively high rates of investment are needed to carry sustained and high rates of economic growth. Since, the domestically generated savings are not sufficient to carry out the development programmes, a huge amount of foreign capital is required. The preference for direct form of foreign capital over other forms of foreign capital i.e. Foreign Institutional Investments (FIIs), commercial loan, foreign aid etc. lies in the fact that it not only provides capital but also technology, management, know-how etc and it aids the productive capacity of the economy. Through this type of foreign capital, the productive capacity of the economy is enhanced along with introducing the structural changes in the economy. It supplements a countries purchasing power because of potential savings, avoiding inflationary pressures, and accordingly prevents exploitation and debilitating situations. Besides, FDI not bears the high interest rates and high cost of debt servicing. Thus, accompanied by low cost, and market accessibility, it promotes export qualities. FDI has found a favour with the respective governments in underdeveloped countries, as structural

changes are superior than the quantitative changes in the inflow of foreign capital in underdeveloped countries in the process of economic development. Mounting debt burden, the meagre foreign exchange earnings and other administrative and structural rigidities have led to the emphasis gradually shifting from the Official Development Assistance (ODA) or commercial borrowing to private capital inflows in the form of foreign institutional investment and foreign direct investment.

In spite of the superiority of foreign direct investment over other sources of financing the external sector, policies of some countries towards foreign capital has been of cautious promotion. However, during 1980s, the attitudes of the developing world changed in favour of foreign direct investment and some countries started encouraging these investments with the hope of reaping the benefits of capital inflows on employment, workers training and technological transfers etc. The year 1991 has provided a fairly liberalized policy framework to attract foreign direct investment. The policies of liberalization have convinced a large number of developing countries including Central and Eastern Europe countries to liberalize their foreign direct investment policies. Even the high growth rate of the East Asian developing economies as a "model of successful outward–oriented development" and its extensive participation in the international economy played a crucial role in the dramatic shift in the attitudes of the developing countries.

The inflow of foreign capital in direct form has increased in the developing countries during 1990s as compared to the 1980s and has been concentrated in the middle income rather than in the low income countries. The other form of foreign capital namely, Concessional finance (major chunk of which is foreign aid) by governments and international institutions have recorded a decline in real terms.

In general, there has been not only a sharp increase but also a fundamental shift in the pattern of foreign investment in the Newly Industrialized Economies (NIEs) and Association of South East Asian Nations (ASEAN), countries in the latter half of the 1980's both of which are essentially trade related. The liberalization of domestic trade policies resulted in more foreign investment flows, which was also due to the fact that trade imbalances have created currency realignments and trade policy restrictions.

Infact in recent years, a more liberal policy towards foreign capital is prevailing all over the world. Attention has also turned to newer roles of foreign capital in providing access to superior technology, managerial skills and marketing channels in addition to the more traditional roles of relaxing domestic savings and foreign exchange.

The accelerating flows of FDI over the 1990s have prompted governments in both developed as well as in the developing countries to attract Multinational Enterprises (MNEs) with various incentive packages to access their resources, viz., capital, technology, skills, market access among others to enhance the process of development. Along with the growth of world flows of FDI, international trade also grew rapidly depicting the increasing internationalization of the world economy. There are increasing trends of Mergers & Acquisitions (M&A) as a mode of investment in Asia Pacific region, partly in response to corporate restructuring in the countries, which reflects the central feature of globalization, a substantial increase in the movement of capital around the world. The flows of FDI in Asia have shifted overtime from Asian NIEs to ASEAN and further to China as a destination due to rising wages and currency appreciation in the former. The FDI flows in the Asia Pacific region is characterized by a decline in intra – regional investment, due to

the financial and other difficulties faced by the Transnational Corporations (TNCs) of the region. There is an increasing share of FDI flows in the service sector, partly because of liberalization but also in direct response to the efforts by some host countries to become regional investment hubs.

The liberalization of core FDI policies including the reduction of barriers, better treatment of foreign investors and assuring the proper functioning of markets with good environment has made possible inward FDI flows. The vehicle for industrial restructuring for most of the country in the region has been FDI. Thus TNCs have acted as a catalyst for industrial restructuring and competitiveness in each country separately and in the region as a whole. As regionalization and the development of regional networks appear to be an internal component of TNCs strategies, the experience of the Asia Pacific group of countries can be instructive as a model of integration based on FDI and trade linkages.

Asia is experiencing a major boom in investment, production and trade over the past few years and there is a double digit growth in China, parts of ASEAN and the Republic of Korea. The rapid absorption of technological development has been combined in several of these countries with the increased regionalization or globalization of production and the liberalization of investment and trade regimes within a framework of market oriented private sector growth. This combination will not only continue to ensure high levels of growth but also requires high levels of investment. Japan, NIEs of Asia, Hong-Kong, Republic of Korea, Singapore, Taiwan and the ASEAN–4 (Indonesia, Malaysia, Philippines and Thailand), have realized rapid economic growth, which is referred to by several observers as an example of the transition. The high economic growth in these economies has been characterized by the changes in the

structure of economic activity with manufacturing industries in particular becoming more important and the migration of production lines in the developing Asian countries. Direct foreign investment by multinationals from USA, Japan, Europe and recently the Asian NIEs and ASEAN–4 economies have played a crucial roles in stimulating growth.[1] The shifting of the primary product exporting and import–substituting industries to some how trade related industries resulted in the attractiveness and international competitiveness of the South – East Asian countries. These trends are visible mainly in Japan and the NIEs, and also in overseas Chinese business communities in the neighbouring ASEAN countries.

The role of FDI in economic development is no longer in doubt, particularly in view of the contribution that foreign capital has made in economic transformation of South – East Asian economies. Although, the role of FDI in economic development is in doubt but a consensus has gradually emerged that foreign capital if properly utilized can contribute significantly to economic development. This perception has been helped in no small measure, by spectacular growth performance of the south – East Asian economies which are acknowledged to have absorbed a significant amount of FDI, though the primary growth impetus may have come from domestic efforts.

FDI has played a very significant role in promoting the economic growth of East and south – East Asia, through cost reduction and export promotion. Facilitated by FDI, there has been industrial restructuring in the region and changes in trade flows, enabling the countries of the region to move upwards on the ladder of industrialization while maintaining internal division of labour. In the process, the countries of the region have

become increasingly intertwined through the linkages of trade, FDI and technology transfer.

The inward – oriented, large – market economies such as China and India have been following a more open policy towards foreign investment. This has provided new opportunities for FDI both from within and outside the region as both of these continental economies have very big markets. China and India have opened up their economies towards FDI to access technology transfer and marketing support for a dynamic and competitive advantage in the present day world.

1.2 CONCEPT OF FOREIGN DIRECT INVESTMENT

Foreign direct investment is defined as external investment by foreign institutions, entrepreneurs, corporate undertakings, transnational corporations and governments etc, in productive units and in developmental activities not only in the form of financial capital but also in the form of technological, managerial and intellectual capital that jointly represents a stock of assets for the production of goods and services. It is defined as an investment made by transnational corporations or by a non-resident individual in the enterprise of host (recipient) countries in order to earn private return. The investing unit has full power over the decision-making process in proportion to its investment. The concept of foreign direct investment is different from mere foreign investment. Foreign investment consists of private and official investment, which includes the foreign direct investment, portfolio investment and export credit.[2]

Foreign direct investment has a special meaning in the sense that it refers to the flows of equity capital into a subsidiary where the foreign

investor (or TNCs) have a controlling interest. Moreover, the former is considered as the long-term investment and the latter is typically guided by short-term considerations of speculative gains. However, the essential criteria should be "controlling interest" and "long term interest". Thus licensing or sale of technology without any financial flows can also give the foreign investor control over the recipient firm's decision-making process. In short, the crucial issue in classifying any foreign investment, as foreign direct investment is that it must involve control by the foreign investors and " Long term' considerations.[3]

Foreign direct investment flows comprises two distinct forms, namely equity and non - equity form of investment. The equity capital comprise of the foreign direct investments purchase of shares of an enterprise, foreign direct investment shares in reinvested earnings and short or long term intra - company loans or debt transactions between foreign direct investment and the affiliates. The non-equity form of foreign direct investment includes investments through such activities as sub - contracting, management contracts, turnkey projects, franchising, licensing and product sharing contracts etc. (UNCTAD, 2000). The sum of these can be briefly stated as follows.

Joint Ventures

Under such investments, the host countries hold 50 per cent of the equity and the equity share is distributed according to their partner's share in financial contribution, and capital contribution such as technology, management or access to world market etc.

Licensing Agreements

These are the contracts under which the MNCs provide the localized license for the right to access a set of technology, trademarks, copyrights or patent or a combinations of these for the specified period in return for their value in terms of a lum sum fee; a package of sales; royalties; shares of equity (and hence profits); or goods bought at a discount as in a counter - purchase or buy - back arrangements.[4] It also entails provisions for access to technological improvements or adaptations the licensee may take. Under licensing agreements there is also a provision of training of personnel in the case of technical assistance agreements.

Franchising

This is a particular type of technical agreement under which the franchisee is being provided with a set of know-how, trademarks, local exclusive technology, and management assistance in return for a fee, royalties and compliance with corporate regulations.

Management Contract

In this type of contract the MNCs are not usually the direct suppliers of plant and equipment but they manage the project for a specified period, which is sufficient to train the local personnel, building up of local operations from scratch etc. Under these contracts, the host country benefits from the managing firm's international reputation, world wide procurement capabilities, knowledge of international product and financial markets and access to funds.[5]

Turnkey Contract

In this form of contract the foreign party is responsible for the period, which is sufficient to build up a complete production unit, and sometimes it also includes the operations and maintenance of the plant or project. These contracts also provide feasibility studies, technology and know-how, basic design and engineering and supply of complete plant and equipment. Turnkey contracts do not necessarily involve a single contractor carrying out operations alone, they can sub-contracts portions of the 'Job' and the technology supplied generally includes some items, which are licensed or embodied in the machinery and equipment supplied by the firms. Turnkey contractors are often engineering firms, engineers, managers, construction workers as well as supplies of the equipment and technology required in the project.[6]

Product-in-Hand Contract

It is a type of turnkey contract under which the contracting party is responsible for overseeing the complete operation of the plant under local personnel. Under such contract the party concerned is responsible for training local management and workers in running the plant.

Product-Sharing Contract

In this form of contract foreign parties are allowed to under take exploration and production along with local enterprises in return for a predetermined share of the physical output. This is usually for a specified period of time, which allows foreign firms to recover their costs. In certain types of joint ventures or management contracts in the field of manufacturing or mining, where the foreign partner assumes no exploration risk, it is paid in the form of dividend or allowed to purchase

a given proportion of output. They are also referred to as product sharing contract.[7]

Risk–Sharing Contract

It is a type of product - sharing contract, with the difference that under such a contract share is paid in cash rather than in physical quantity. Under such contracts foreign party capital is reimbursed with interest and a risk fee is paid out of the production revenue.[8]

International Sub–Contracting

Under this form of contract foreign partners enter into a contract with the sub-contractor in the host country to produce components or assemble finished products with the inputs they provides. Under such form of contract, the principal contractor normally sells the final output. But, under this only those international subs - contracting arrangements are included, which have 50 per cent ownership of the host country firm. Thus, it excludes intra-firm relationships involving majority foreign - owned subsidiaries in developing countries and their foreign principals.[9]

1.3. IMPORTANCE OF FOREIGN DIRECT INVESTMENT

In recent years, Asia and the Far East have seen the emergence of some of the fastest growing economies of the world. In a very large measure, these economies have been highly externalized and the main factors have been export-led growth. Some of the larger continental economies like India and China have followed a different logic and their path of economic development have been intrinsically linked to their socio-economic philosophies. Foreign direct investment is not only just a source of capital but also of new technology with other intangibles such

as organizational, managerial and marketing skills. It boost trade and economic growth of income, output and employment in the host country by providing a stimulus to the production of locally produced inputs and innovation, saving and capital formation. Foreign direct investment gives the investor a stake in the economic development of the host country. An additional benefit of inflow of foreign direct investment is that it brings superior technology in the country. It increases competition by setting up firms and producing goods at cheaper costs and so expands the industrial base of the country. The availability of considerable skills at a competitive cost, and the kind of export processing activity currently in evidence in the ASEAN countries may gradually also emerge in other countries. Foreign investment can play an important role in this direction, and it can help in meeting even the huge requirements of a domestic economy.

Foreign direct investment has gained importance globally as an instrument of international economic integration. Foreign direct investment policies along with trade policies have infact become the focus of liberalization efforts in almost every developing country. A liberalized trade regime along with an open door foreign direct investment policy creates pressure to achieve higher levels of efficiency and flexibility at the firm level.

The efficacy of the inflow of foreign direct investment depends upon its meaningful utilization. To succeed in this direction is advisable to focus upon and identify the areas in which the injection of capital and know how becomes fruitful from the developmental point of view, for example, the inflow of foreign direct investment related to export sectors

especially through medium and long term investment projects can fulfill the developmental needs of the host country. This gives a boost towards optimal utilisation of natural resources, manpower and creates an atmosphere conducive to providing efficient and cheap availability of superior goods and services.

Moreover, one of the important contributions of private foreign investment to national development is its role in filling the resource gap between targeted or desired investment and locally mobilized savings. The so-called " Two Gap" model between targeted foreign exchange requirements and those derived from the net export earnings plus net public foreign aid can be filled by inflow of foreign direct investment. Through the taxation of the profits of MNCs and their participation in the financial operations promotes a balance between required revenue and targeted government tax accruals and revenue thereof is promoted.

Furthermore, multinationals provide financial resources and new factories to underdeveloped countries and supply a package of necessary resources including management experience, entrepreneurial abilities and technological skills – eventually transferred to their local counterparts by means of training programmes and the process of in house training.

MNCs educate local managers on how to establish contracts with overseas banks, diversify market outlets, and become better acquainted with international marketing practices. Finally, MNCs bring with them the most sophisticated technological knowledge about production processes and transfer of modern machinery and equipment to capital deficient third world countries. Such transfer of knowledge, skills and

technology are assumed to be both desirable and productive for the recipient countries.[10]

1.4 THEORIES OF FOREIGN DIRECT INVESTMENT

The growing importance of FDI and its effectiveness has led to the development of a number of theories explaining why MNCs indulge in FDI; why they choose a specific country in preference to another to locate their foreign business activity; and why they choose a particular entry mode. These theories have also tried to explain why some countries are more successful than others in obtaining FDI. Various economists have put forward a number of determinants regarding FDI. The theory can be briefly stated as follows.

1.4.1 Differential Rates of Return

This theory, states that the differential rates of return between the home country and the host country is the crucial factor for FDI to take place. Capital flows from its country of low rates of return to a country with high rates of return. The rationale for this theory is that firms considering FDI behave in such a way as to equate the marginal return on and the marginal cost of capital. The hypothesis obviously assumes risk neutrality, making the rate of return the only variable upon which the investment decision depends. Risk neutrality in this case implies that the investor considers domestic and FDI to be perfect substitute or in general that direct investment in any country, including the home country is a perfect substitutes for direct investment in any other country.[11] However, the fact that this theory could not be supported by empirically (Agarwal, 1980 and Weintraub, 1967). They have failed to find a significant

relationship between inter- country differences in the rates of return and FDI flows. Some have rejected the differential rates of returns, and stressed the adequacy of the return as a precondition for the movement of capital (Bandera and White, 1968). This theory, however does not explain the simultaneous occurrence of inflows and outflows in a country.

1.4.2 Portfolio Diversification

The crucial factor in this theory is the minimization of risk through diversification of portfolio. The essential assumption of this theory is that a firm could reduce its overall risk by investing in more than one country. The choice among various projects is therefore guided not only by the expected rate of return but also by the risk.[12] The theoretical foundations of this hypothesis can be traced back to the theory of portfolio selection (Tobin, 1958 and Markowitz, 1959). However, the empirical results on the basis of various studies offer only weak support (Agarwal, 1980 and Hufbauer, 1975).

1.4.3 Level of Sales / Income

According to this theory, the size of the FDI in a host country depends on its market size, which is measured by the sales of MNCs in that country or by the GDP of the countries. As the size of the market determines the operation of the optimum economies of scale, the country becomes a potential target for FDI inflows. It has been pointed out that a sufficiently large market allows for the specialization of the factors of production, and consequently the achievement of cost minimization (Balassa, 1996). In other words, a higher level in the sales of the foreign subsidiaries and in the host country's income would lead to higher FDI. The rationale for the hypothesis that firms increase their investment in

response to their sales is based on the Neo-Classical domestic investment theories, the most popular of which is represented in (Jorgensons, 1963); which was a generalized form of the earlier flexible acceleration model (Chenry, 1952 and Koyack, 1954). However, the empirical evidence in support of this theory are rather mixed. The relevance of GDP as a measure of potential market size does not have much theoretical foundation. But most survey analysis studies have produced results supporting the relationship between FDI on the one hand, and the sales of foreign subsidiaries and / or GDP on the other.

1.4.4 Industrial Organisation

The industrial organisation theory states that inspite of the disadvantages in language, culture, the legal system and other inter-country differences, the MNCs posses numerous advantages which is attributed to their brand name, patent protection, superior technology, marketing and managerial skills, cheaper sources of financing, preferential access to markets and economies of scale enabling them to invest in a foreign country (Hymer, 1976). However the comparative advantages have to be firm specific, they must be transferable to foreign subsidiaries, and should be large enough to overcome disadvantages. FDI may also occur because it is difficult to sell or lease these intangible assets. Intangible assets that cannot be sold such as through the MNCs managerial and organizational capabilities, the experience and the spirit of its executives, its standing in financial markets, and its contracts with various officials and other firms.[14] The industrial organisation theory, simply explains why firms invest in foreign countries, but it does not explain why firms prefer to a particular country (Kindlerberger, 1969).

1.4.5 Internalization

The internalization theory of FDI states that, FDI facilitated though the efforts by firms to replace market transactions with internal transactions. The problem associated with the market transactions is linked to market imperfections and failure of markets to provide intermediate goods, including human capital, knowledge, marketing and management expertise. The advantages of internalization lie in the avoidance of time lags, bargaining and buyer uncertainty. Indeed, the main motive for internalization is the presence of externalities in the goods and factor markets. It is difficult to design and enforce contractual arrangements that prevent some one who has purchased or leased a technology from passing it to others without the knowledge of the original producer. FDI is expected to be continued till the benefits (e.g. avoidance of time lags and buyer uncertainty, minimization of the impact of government intervention through transfer pricing etc.), accrued from further internalization. If markets in intermediate products are imperfect, firms have an incentive to bypass them by creating internal markets, such that the activities linked by the markets are brought under common ownership and control (Bucklay and Casson, 1976). The internalization of markets across national boundaries leads to FDI, and this process continues until the marginal benefits and marginal costs are equal.[15]

1.4.6 Location Theory

The basic idea behind this theory is that FDI is being attracted by location advantage, which is due to the immobility of some of the factors of production, such as labour and natural resources. This immobility leads to location related differences in the cost of factors of production. The

location specific factors may result in low cost of production which may be due to low wages, and low cost of capital etc. That the level of low wages in the host country relative to high wages in the home country is an important determinant of FDI. Likewise, the availability of skilled labour with low wages and the aviability of the capital at low cost may facilitate FDI. However, the empirical studies on the location specific peculiarity of FDI have a mixed result.

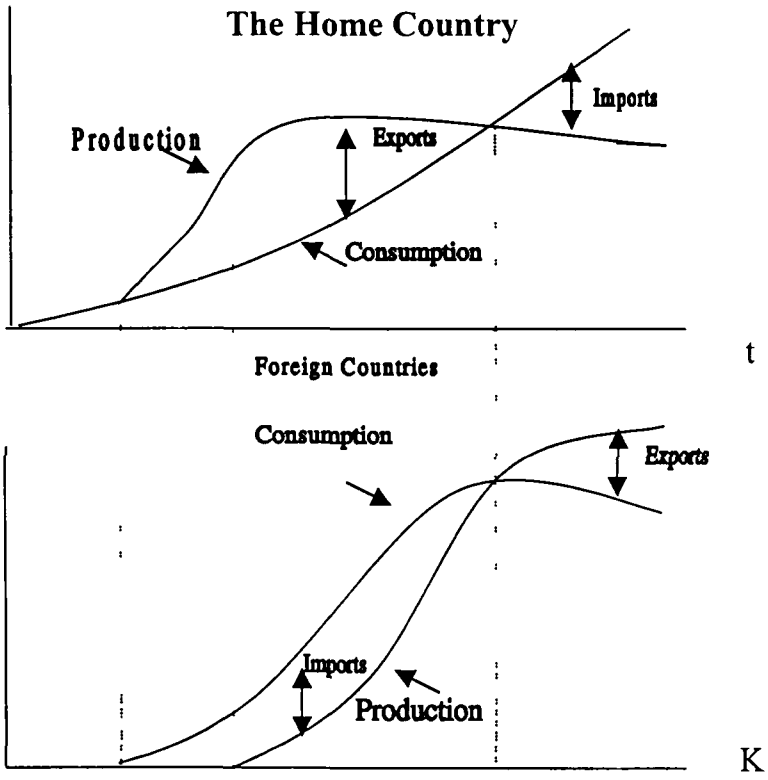
1.4.7 Eclectic Theory

Dunning developed this theory by integrating three theories namely, the industrial organization theory, the internalization theory and the location theory. According to this theory, three conditions must be fulfilled for FDI to take place. First, a firm would undertake FDI if it has ownership advantage (i.e. right to a particular technology, monopoly power and size, access to new materials, and access to cheap finance); that it must have comparative advantage over other firms arising from the ownership of some intangible assets. Second, it must be more beneficial for the firm to use these advantages rather than to lease them. These are the internalization advantages that refer to the choice between accomplishing expansion within the firm or selling the rights to the means of expansion to other firms. Third, it must be more profitable to use these advantages in combination with at least some factor inputs located abroad.[16] Moreover, this theory suggests that all forms of FDI can be explained by reference to its conditions. It acknowledges that advantages arising from ownership, internalization and location may change with time, and accepts that if country specific characteristics are important determinants of FDI, it may be invalid to generalize it.

1.4.8. Product Cycle

This theory was developed to explain the expansion of US MNCs after the Second World War and offered a useful explanation for the interaction between the production, exports and FDI during 1950s and 1960s (Vernon, 1966). A subsequent hypothesis clarified that a product goes through a cycle of initiation, exponential growth, slow down and decline that is a sequence that corresponds to the process of introduction, spread, maturation and senescence (Vernon, 1971).[17]

Figure.1 Relationship between Production, Consumption and FDI during the Product Life Cycle



The product life cycle hypothesis as in the fig 1, suggests that a product has to go through three stages. Firstly, a country undertakes commercial application (innovation) of scientific invention and produces

new products. In this stage, the demand for the product is price inelastic and so the innovating firm can charge a relatively high price. During the course of time, the product is improved and there is a demand from the customers living in the home country. Secondly, in this stage, the product matures and is standardized with mass production. It is now exported by the innovator country to other countries. As the demand continues to grow and competition emerges, the innovator firm resorts to FDI in those countries to meet local demand. In this stage, the innovating country dominates the export market and in the final stage, the product along with production process becomes completely standardized and it is no longer remains the exclusive property of the innovator firm. At this stage, price competition from other producers forces the innovating firm to invest in developing countries, seeking cost advantages. The home country starts to import the product from both domestic and foreign firms. The home country becomes net importer, while foreign countries become net exporters (Agarwal, 1980). There is an evident forceful association between the propensity to invent new products, export performance, FDI, and the ratio of the local production to export on the one hand, and R&D expenditure of the US industries on the other.[18]

1.4.9. Catching up Product Cycle

This theory basically rests on the import substitution measures which facilities FDI. Under this model, the product cycle starts with the imports of new superior quality product. The domestic product becomes viable and is assisted by importing technological know-how and by FDI. The expansion of production then leads to the economies of scale;

increases in productivity; improvement in quality and reduction in costs. As the cost of production is reduced and becomes of international standard, foreign markets are developed, the scale of production is extended and costs are reduced further.

1.4.10. Oligopolistic Reaction

The Oligopolistic reaction theory asserts that the race for maintaining market share among the Oligopolistic firms facilities FDI. This theory agues that a move by one firm to establish production facilities abroad may be interpreted by rivals to imply a threat to status quo, thus inducing counter moves. The first move may be prompted by government action or by something else, but as Lall and Streeten argue, the subsequent pattern cannot be interpreted in terms of the profit maximizing behaviour of an individual firm independently or the actions of the rival firms.[19] The firms under monopolistic or Oligopolistic industries at home are better placed and have the necessary incentives to commit resources to research and development. There are three kinds of Oligopolies (innovative, mature and senescent) and the different pressures they generate for firms concerned (Vernon, 1974). The Oligopolistic reaction increases with the level of concentration, and decreases with the diversification of the product and such firm try to counter any advantages that their rivals may obtain from its FDI by their own FDI and try to maintain their competitive position. The increased industrial concentration causes reaction among Oligopolies in field of FDI and the profitability of FDI is positively correlated with entry concentration and inversely correlated with the product diversity (Knicerbock, 1973). However, this theory doesn't explain the initial investment that starts the competition for FDI and how it overcomes the existence of other methods catering to foreign markets.

1.4.11. Internal Financing

This theory is based on the gamblers 'learning' hypothesis of Barlow and Wender who postulate that MNCs commit a modest amount of their resources to their initial direct investment, while subsequent expansions are financed by investing profits obtained from operations in the host country.[20] An expansion of the FDI is made by the retained earnings of subsidiaries and there is a positive relationship between the internal cash flows and investment outlays. The situation of internal financing is better as compared to external financing not only because of lower cost but also due to the free movement of funds and the availability of information about the capital markets.

Hartman, provides a tax-based explanation as to why MNCs like internal financing. He states that, because repatriated earnings are taxed in the home country so MNCs finance FDI out of foreign earnings to the greatest possible extent. That is a firm required foreign return is set at the point at which desired FDI just exhaust foreign earnings. However, the internally generated funds are allocated among the parent subsidiaries by the top management in such a way as to maximize profits from the point of view of the whole concern (Severn, 1972). In a study it was found that the most important sources of funds required for expansion are undistributed profits and depreciation allowance (Brash, 1966; Safarian, 1969; Kwack, 1972 and Hoelscher, 1975).

1.4.12. Currency Area

This theory has been put forward and is an attempt to explain the relative strength of various currencies to effect FDI flows (Aliber, 1971). The theory states that a country with a strong currency tends to invest abroad and less likely that foreign firms will invest in that country. The countries with weak currencies tend to be the host countries or recipients of FDI, whereas the country with strong currencies tends to be a source of FDI. This theory is based on the capital market relationships; exchange

rate risks; and market preference for holding assets in selected currencies. He argues that MNCs in a hard currency area is able, based on reputation to borrow at lower rates in a soft currency country from local firms of and so are more efficient in hedging foreign exchange risk. The FDI flows are related with overvaluation and undervaluation of a currency where former causing outflow and the later is associated with inflow of FDI. Froot and Stein argue that a weak currency may be associated with FDI inflows resulting from informational imperfections in the capital market, and that these imperfections make the cost of external financing higher than the cost of internal financing.[21] In spite of the overvaluation and undervaluation of a currency the exchange rate also effects FDI flows, especially when FDI can be viewed as an alternative to exports. Thus, if the domestic currency appreciates against foreign currencies, MNCs based in the home country would find it difficult to export, as domestic goods become less competitive. If the appreciation of the domestic currency persist, the MNCs may find it useful to move abroad, resulting in a rise in FDI. In this case, FDI can be viewed as a measure taken to hedge economic exposure to foreign exchange risks. Moreover, the real exchange rate is determined by the nominal exchange rate and relative inflation, the latter is a factor that influences FDI flows. The depreciation is an incentive for FDI, whereas the appreciation of the currency is a restrictive factor in the FDI flows.

Caves argues that the effect of the exchange rate on FDI runs through two channels. First, changes in exchange rates leads to changes in the investor's costs and revenues. The net effect of FDI is ambiguous, depending on certain characteristics of the underlying business activity. The second channel is associated with expected short-term exchange rate movements. A depreciation that is expected to be reversed will encourage FDI inflows to obtain capital gains when the domestic currency appreciates.[22] Moreover, the effects of exchange rate variability also

depends on the objectives of FDI. If investors aim at serving the local market, than FDI and trade are substitutes, in which case an appreciation of the currency of the host country attracts FDI flows. If however, the objective is to re – export than FDI and trade are complements and the appreciation of the currency of the host country reduces FDI inflows through lower competitiveness.

Figure.2 Relationship Between Currency Misalignment and FDI Flows

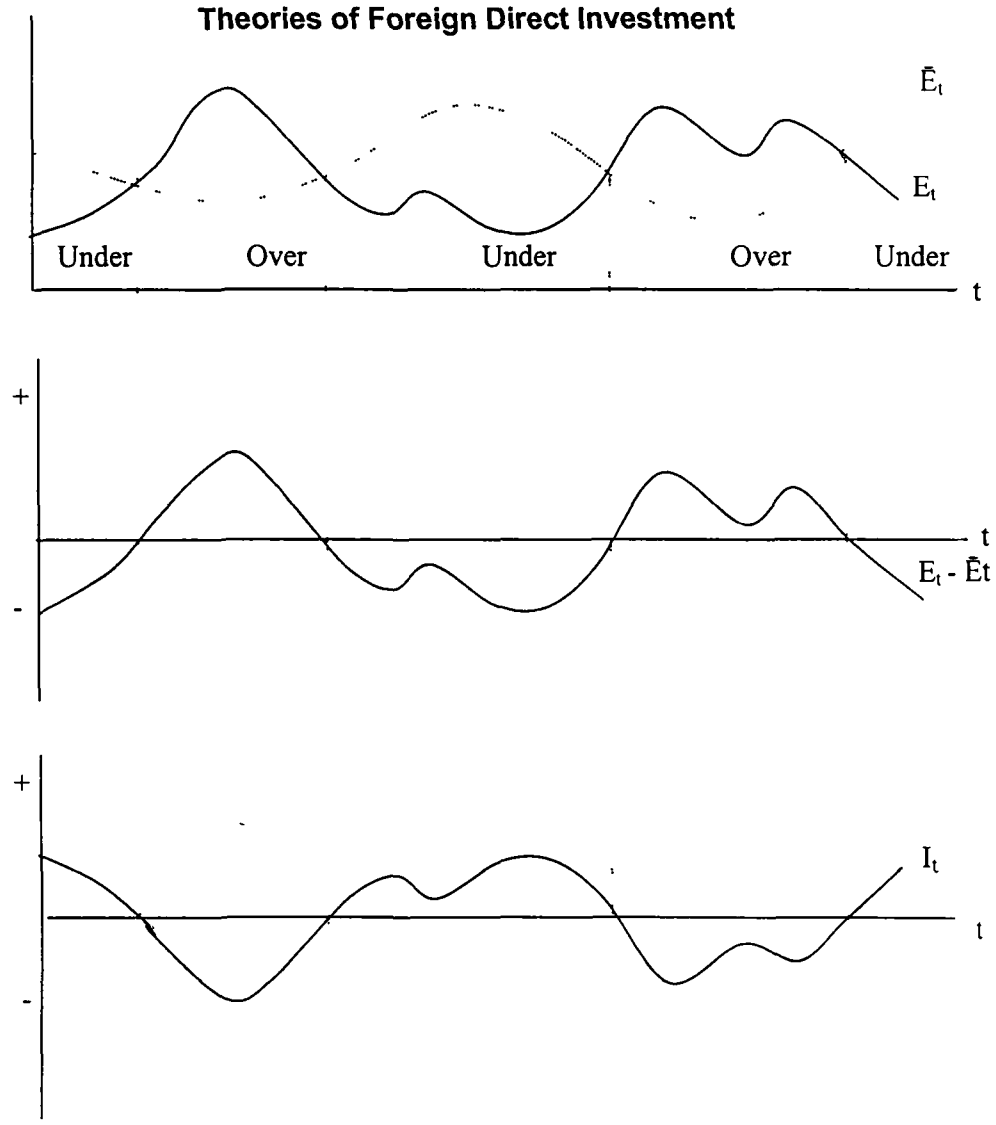


Fig (2) represents the relationship between misalignment (overvaluation and undervaluation), changes in the exchange rate (appreciation and

depreciation), and FDI flows. In the figure E_t represents the actual exchange rate and $\bar{E}_t$ represents equilibrium level of exchange rate. When E_t is below $\bar{E}_t$ the currency is undervalued and when E_t is above $\bar{E}t$ the currency is overvalued. This is also shown in the middle part of figure, where the currency is said to be undervalued when $E_t - \bar{E}_t < 0$ and overvalued if $E_t - \bar{E}_t > 0$. In the third episode (undervaluation) the currency depreciates and appreciates, the same is true for the fourth episode (overvaluation) in which the currency appreciates, depreciates and moving towards the elimination of the misalignment. The third part of the diagram shows FDI flows (+ indicates inflows and – indicates outflows). The figure, shows that episodes of undervaluation are associated with FDI inflows, whereas episodes of overvaluation are associated with FDI outflows. This is the relationship between misalignment and FDI flows. But in the third episode it can be seen that, when the currency is undervalued, FDI outflows rise and fall and when it is overvalued (as in the fourth episode) FDI outflows rise and fall. This is the relationship between changes in the exchange rate and FDI flows.

The relationship between FDI and the exchange rate, as shown in the figure can be represented algebraically as follows

$$I_t = f_1 (E_t - \bar{E}_t) + f_2 (E_t - E_{t-1})$$

Where I is FDI flows,

$f'_1 > 0$, $f'_2 > 0$ and $f_1(E_t - \bar{E}_t) | > | f_2(E_t - E_{t-1}) |$.

The term $f_1 (Et - \bar{E}_t)$ represents the dependence of FDI on overvaluation and undervaluation of the currency, whereas the term $f_2(E_t - E_{t-1})$ represents the dependence on currency appreciation and depreciation. The theory has some empirical support but cross investment between currencies areas cannot be explained by it.

1.4.13. Barriers to International Capital Flows

This theory states that for FDI to take place two conditions must be fulfilled namely, barriers to portfolio flows must exist that are greater than those to FDI and investors must recognize that multinational firms provide a diversification opportunity that is otherwise not available. Errunza and Senbet developed a model whereby investors demand diversification and MNCs supply diversification services, an activity that is reflected positively in the price of their stocks. The empirical results showed that there was a systematic relationship between the extent of international involvement and excess market value. Furthermore, the relationship was found to be stronger in periods characterized by the presence of barriers to capital flows.[23]

1.4.14 Political Stability

This theory states that along with economic factors, political factors are also important in determining the volume of FDI in a country. Political instability and disturbed social environment are generally not conducive for FDI to take place. Generally, political risk arises because unexpected change in the legal and fiscal framework may affect the economic outcome of a given investment in a drastic manner.

1.4.15. Tax Policies

This theory states that the difference between the level of taxation between the home and the host country causes FDI to take place. It is because the return on foreign investment is affected by the tax system of both the home country and the host country, therefore the tax policies do affect the incentives for FDI. Jun identifies three channels through which tax policies affect the decision taken by MNCs. First, the tax treatment of income generated abroad has a direct affect on the net return on FDI. Second, the tax treatment of income generated at home affects the net

profitability of domestic and foreign investment. Third, tax policies affect the relative cost of capital of domestic and foreign investment.[24]

1.4.16. Trade Barriers

This theory asserts that tariff barriers and protection in the trade regime has also caused FDI to take place. FDI is taken as an alternative to trade and to overcome the complexities of trade restrictions. This means that open economies without many restrictions on international trade should receive fewer FDI flows. Tariff rate has a significant effect on FDI (Bajo-Rubio and Sosvilla - Rivero, 1994). Ratio of trade to GDP is a measure of the openness of the economy (Hufbauer, 1994). Countries which are more open to trade tend to provide and receive more FDI (Lipsey, 2000). FDI is used to defuse tariff barriers along with protection. Further it was found that FDI may be induced by the threat of protection, and that it may be used as an instrument to defuse protectionist threats (Blonigen and Feenstra, 1996).

1.4.17. Government Regulations

This theory of FDI asserts that the policy of a country is an important factor that determines the volume of FDI in a country. The government regulations aim at both encouraging and discouraging inward FDI by offering incentives on the one hand, and disincentives on the other. The incentives include, fiscal incentives, financial incentives and market preference etc, whereas the disincentives include the conditions on the level of employment, transfer of technology etc. Incentives have a limited effect on the level of FDI as investors base their decision on risk and return considerations (Agarwal, 1980). However, the empirical results have generally observed that incentives have a limited effect on the level of FDI. As said earlier investors seem to base their decision on

risk and return considerations that may be marginally affected by those incentives.

1.5 OBJECTIVES OF THE STUDY

This study aims at analyzing the policy framework and foreign direct investment flows in the selected Asian countries, especially India.

It seeks to examine the real worth of foreign direct investment flows in selected Asian countries and its effectiveness in creating favourable environment in the host country.

In drawing up the design of this study the following objectives were set up.

i) To analyse the nature and the background of foreign direct investment flows and the technological transfer effect of Multinational Corporations.

ii) To examine the socio-economic background of developing countries and its influence on FDI flows.

iii) To examine the policy changes and other factors that affect foreign direct investment flows in developing countries.

iv) To have a comparative analysis of government policies with foreign direct investment flows in selected Asian countries.

v) The study aims at economic analysis of foreign direct investment flows, and to identify the determinants of foreign direct investment flows in selected Asian countries.

vi) Finally, this study aims at a comparative analysis of the relationship between foreign direct investment flows and various macroeconomic variables in selected Asian countries.

1.6. HYPOTHESIS OF THE STUDY

This study has sought to test the following hypotheses

(i) That a host of structural, geographical and policy factors are important in shaping the pattern of multinational enterprises activity.

(ii) The changes in the policy and development strategy may maximize the gains from FDI.

(iii) Greater openness and higher levels of domestic investment activity attract higher levels of FDI.

(iv) The effects of FDI flows on macroeconomic variables are different in different countries.

1.7 LITERATURE REVIEW

Foreign direct investment has an international orientation and global importance as an instrument of international economic integration. In fact it has become a part of day-to-day economic life around the world. The literature on foreign direct investment is massive and this section presents a brief introduction about the pioneer works carried out by eminent economists and national as well as international organisations. Their works regarding foreign direct investment are of immense value, keeping in view the strategic requirements in these countries.

In the past there has been substantial work studying the effects of direct foreign investments on the Newly Industrialized Economies (NIEs) and ASEAN-4 economies Viz, Galenson, 1985; UN, 1985; Nayavichit Vadakan and Kerdepule, 1987. The effects of US domestic foreign investment abroad have been studied in (Bergeston, Horst and Moran, 1978; Lipsey and Weires, 1981,1984; Bolmston, Lipsey and Kulchycky,

1988). There are some studies on Japanese domestic foreign investment abroad effecting Japanese economy (Goto, 1988).[25] Some others who have emphasized the various aspects of foreign direct investment, have been done by John Dunning, Robert Lipsey, Jamuna Agarwal and Shujino Uvats, 1998; Bala Basa, 1964; Deepak Lal, 1997, and Nagesh Kumar, 1998.

Some have pointed out the numerous determining factors of foreign direct investment. Besides return and costs, liquidity and diversification as other important determinant of foreign direct investment (J.P. Agarwal, 1976).

Among the factors that determine the distribution of FDI flows across developing countries includes among others Per capita income, growth rate, extent of urbanization, availability of infrastructure, political uncertainty and BOP position (Root and Ahmed, 1979; Scheneider and Frey, 1985). A study on direct foreign investment for the period 1964 to 1970 found that the net economic benefits of such investment was negative as it proved to be an expensive form of borrowing and their contribution to external trade was also found to be negligible (Kelkar, 1984).

DR. J.H. Dunning has analysed the capacity of the developing nations to absorb investment. The population and level of skills in a country are the determinant of the capacity of an economy to absorb foreign direct investment. According to a study, direct investment seems to be positively related to the level of market size and its underlying growth, but does seem to react systematically to short term change in rates of market growth (Pierce, 1991). Once a market attains a size that permits the local production to realize effectively economies of scale, the level of foreign direct investment in that market is linked closely to its

size. Regulations in areas such as remittances, price controls and investment do not seem as influential on investment decision as economic factors.[26]

In an empirical study on liberalization as determinants of FDI regarding 46 countries found no significant relation. It was that the FDI flows are strongly influenced by the size and growth of the host economy rather than by changes in the government FDI policies (Contractor, 1990).

Similarly, another related study covering the period 1982-1998 noticed the importance of the quality of infrastructure, level of industrialization and market size in attracting American FDI. He too has also found that FDI incentives were found to be of limited importance in determining their investment decisions (Helers and Mody, 1992).

A study analyzing the impact of MNCs on growth observed that such corporations have made significant positive contribution in the growth of capital formation and transfer of technology in developing countries. It has also noticed improved export performance because of shift of exports to technologically advanced products (UNCTAD, 1992).

Shen Xiao Fang, in a study on the first decade of China's experience with FDI emphasized that in spite of the difficulties and set back, initial FDI performance made a significant contribution to the Chinese economy during this period and FDI had already reached a critical stage in which fundamental socio-economic problems were destined to hinder its further development.

A survey of literature on FDI in developing countries has studied technology spillovers from FDI in Indian manufacturing firm empirically and has found significant indirect benefits from FDI (De Mello, 1997 and Kathuria, 1998). A study done by Golberman and others on the issue of

the effects of policy changes on inward and outward FDI found that the free trade agreements had positive effects, whereas the screening of the projects have no significant effect on the FDI. Another related study on the issues of effects of capital controls on the volume and composition of capital flows concludes that the capital controls influence the composition of flows, but sterilized intervention influences both volume and composition of FDI flows (Monteil and Reinhart, 1999).

The numerous studies on the relationship between the FDI and country risk have pointed out that there exists a significant relationship between FDI and country economic and political risk (Lehman, 1999; Ramcharran, 1999, and Pistoresi, 2000). The other studies on the relationship between FDI and regulatory changes in Asian countries have found that there exists a significant correlation between reform expectations and FDI flows (Thompson and Poon, 2000). A study on the location as a determinant of FDI has pointed out regional market size, good infrastructure and preferential tax policy effects positively, whereas wage cost effect negatively (Cheng and Kwan, 2000). The study related to export and FDI by Donnefield and Weber (2000), taxes and FDI by Wei (2000), FDI and exchange rate volatility by Sung and Lapon (2000), and Moshirian (2001), on FDI and banking pointed out that the major determinants are bilateral trade, banks foreign assets, costs of capital and exchange rates. A more recent study on the effects of liberalization on FDI flows pointed out that the policy changes are more important for FDI than GDP growth rate or exchange rate (Sin and Lung, 2001).

1.8. RESEARCH METHODOLOGY

The statistical data can be collected from Primary sources and Secondary sources.

The primary sources include the data collected from the person concerned directly or indirectly through questionnaires. The secondary sources include published and unpublished data collected from different agencies and government offices, which is used for further studies.

The study has relied extensively on published accounts, reports and proceedings of national as well as international organizations. It include the data collected from the publications of World Bank, Asian Development Bank, United Nations UNCTAD, NCAER, IMF, OECD, MOFTEC, MIDA, EDB, RBI, IIFT and India's Investment Center.

The perception of the problem is portrayed in the study with the help of economic principles and statistical techniques. A simple and basic statistical analysis like, Minimum value, Maximum value, Mean, Standard Deviation, Coefficient of variation and Correlation coefficient is carried out primarily with the help of Secondary data available from various sources for the period 1990-2001.

Growth rates of FDI in selected Asian countries namely China, Indonesia, Thailand, Singapore, Malaysia and India have been calculated by taking time as independent variable and rest of the variable (Country-wise and Sector-wise break-up of FDI) as dependent variable.

The equation for the calculation of the growth rates is the well known Compound interest formula as follows,

$Y_t = Y_o + (1+r)^t$ ----------(1)

Where Y_t is real growth rate at time t and Y_o is the initial (i.e 1990) value of FDI flows and " r " is the compound (i.e., over time) rate of growth of Y

Taking the Natural Logarithm of the equation —(1)

$\text{Ln } Y_t = \text{Ln } Y_0 + t \text{ Ln } (1+r)$----------(2)

Putting $\beta_1 = \text{Ln } Y_o$ and $\beta_2 = \text{Ln } (1+r)$ in equation (2) Now can be

Written as,

$$\text{Ln } Y_t = \beta_1 + \beta_2 t \text{----------(3)}$$

Equation (3) shows that regress and is the Logarithm of Y_t and the regressor is 'time' and the percentage compound rate of growth is calculated by taking antilog of regression coefficients, subtracting "1" from it and multiplying the difference by 100. All the results presented in regression results and are Tabled in 3.2(b), 3.3(b), 3.5(b) 3.6(b), 3.8{b), 3.9(b), 3.10(b), 3.12(b), 3.3(b), 4.2(a), 4.3(b) and 5.1(b) respectively.

1.9. PLANNING OF THE RESEARCH WORK

The study is planned in different chapters followed by bibliography as follows.

Chapter-1: It is the introduction of the study. It goes into the background of the concepts related to foreign direct investment. It discusses the various theories of foreign direct investment. It highlights the importance, objectives of the study, available work on foreign direct investment and planning of the research work.

Chapter-2: It deals with the role of foreign direct investment in developing economies. It provides an eye view of the socio-economic aspects of foreign direct investment flows in the developing economies. It goes into the details of the impact of foreign direct investment flows on the developing economies.

Chapter-3: It presents the separate study of the foreign direct investment scenario in selected Asian countries namely China, Indonesia, Thailand, Singapore and Malaysia. It deals with the respective government policy framework associated with foreign direct investment flows.

Chapter-4: It comes up with the foreign direct investment scenario in the Indian economy. It covers both the pre-reform and post-reform period

policy framework associated with foreign direct investment flows. It also covers the hurdles in the way of smooth flows of foreign direct investment follows by suitable suggestions.

Chapter-5: It gives an account of the various determinants of foreign direct investment along with regulatory framework in selected Asian countries. It presents the comparative analysis of the foreign direct investment trends in top ten Asian countries along with a model, analyzing the relationship between foreign direct investment and various macroeconomic variables.

Chapter-6: It sums up the study with a conclusion and suitable suggestions.

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CHAPTER-2

Chapter –2

ROLE OF FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES

2.1 SOCIO-ECONOMIC BACKGROUND OF DEVELOPING COUNTRIES

The term "underdeveloped country" is a relative term and has been used in a variety of ways. It is usually used for countries, which have potentialities of development but are characterized as poor due to low rate of capital formation. They are basically agrarian in nature and lack of industrialization has hindered the creation of a demand for their products in export markets. In general, those countries are characterized as underdeveloped: whose real per capita income is less than a quarter of per capita income of the United States. More recently, instead of referring to these economies as underdeveloped, the United Nation publications prefer to describe them as "developing economies." The term developing economies signifies that though still underdeveloped, the process of development has been initiated in these countries.

The World Bank Report (2002) has classified these countries in terms of GNP per capita. The developing Countries are divided into low income countries with a GNP per capita income up to US $755, whereas the middle income countries with a GNP per capita between US $756 and US $9265. High income countries have GNP per capita above US $9265 in the year 2001. In the year 2001, low income countries comprise 40.9 per cent of the world population, but account for only 3.4 per cent of the total world GNP. The middle-income countries comprise 43.5 per cent of the world population and account for 15.8 per cent of the world GNP.

The first two group of countries are popularly described as developing countries with 85 per cent of the world population and a mere 20 per cent of the world GNP. It comprises most of the countries of Asia, Africa, Latin America and some countries of Europe. Whereas the high income countries comprise only 16 per cent of the world population and account for the 81 per cent of the world GNP. The above facts signify that the bulk of the poor people reside in the low-income and middle-income countries. They, to quote Cairncross, constitute the "slums of the world economy".

India with its population of 1016 million in 2000 and with a per capita income of US $460 is among the poorest of the economies of the world. It has a share of 16.8 per cent in world population, but accounts for only 1.5 per cent of the World GNP. To quote Professor Jacob Viner an underdeveloped country is "a country which has good potential prospects for using more capital or more labour or more available natural resources or all of these to support its present population on a high level of living or if its per capita income level is already fairly high to support a large population on a not lower levels of living".[1]

While almost all the developing countries are diverse in culture, economic condition, social and political structures. Despite the obvious diversity of countries and classification schemes, however most Third World countries share a set of common and well-defined goals. These include reduction in poverty, inequality and unemployment, the provision of minimum standards of education, health, housing and food to every citizen, the broadening of economic and social opportunities, and the forging of a cohesive nation state. Related to these economic, social and political goals are the common problems shared in varying degrees by most developing countries are widespread, chronic and absolute poverty,

rising levels of unemployment, underemployment, growing disparities in the distribution of income, low levels of agricultural productivity, growing imbalances between urban and rural levels of living and economic opportunities, environmental decay, antiquated and inappropriate educational and health system. Severe BOP and international debt problems, substantial and increasing dependence on foreign aid, inappropriate technologies, institutions and value systems are also analogous characteristics.[2]

In spite of the obvious physical, demographic, historical, cultural and structural differences most Third World countries face very similar economic and social dilemmas. For the sake of convenience the common characteristics can broadly be classified as follows.

1. Low Levels of Living

In most of the developing countries, levels of living tend to be very low not only in relation to developed countries, but often also in relation to small elite groups within their own societies. These low levels of living are manifested quantitatively and qualitatively in the form of low incomes, inadequate housing, poor health, low literacy, high infant mortality, low life and work expectancies etc.

GNP Per Capita

This is often used as a relative measure of well – being of the people in different countries. The GNP itself is the most commonly used measure of the over all levels of economic activities. The underdeveloped countries are not only having a low GNP per capita as compared to the developed countries but the income inequalities in the underdeveloped countries have also been increased. According to the World Bank estimates in 2001, the average GNP per capita of the high income countries was $ 26,710, whereas for the low income countries was $430,

which is 62 times lower than the high income countries. The middle income countries have an average GNP per capita of US $1850 that is 15 times lower than the high income countries. Simultaneously, GNP per capita income of both lower and middle-income countries is 12 times lower than the high-income countries.

Distribution of National Income

The national income is not only distributed unevenly between developed and developing countries, but the income is distributed more unevenly among the developing countries as well. In other words, there is a wide disparity in income distribution in developing countries. If we compare the share of national income that accruing to the poorest 60 per cent of a country's population with that of the richest 20 per cent than it will be a rough measure of the income inequality. This can be stated from the fact that in USA, lowest 20 per cent have 5 per cent share while highest 20 per cent is having 46.4 per cent in national income during the year 1997. Whereas in South Africa the lowest 20 per cent are Just having 2 per cent share whereas the highest 20 per cent are having 66.5 per cent share in national income in the year 2001. In Brazil, lowest 20 per cent are having 2.2 per cent whereas highest 20 per cent are having 70.3 per cent share in GNP.[3]

The underdeveloped countries such as Kenya, Colombia, Malaysia, Brazil, Mexico, Venezuela, Thailand and Argentina have considerable degree of income inequality, while developed countries such as Finland, Australia, Netherlands, Sweden, USA and Japan are having relatively less inequality.

The above phenomenon underlines the important point that economic development cannot be measured solely in terms of the level and growth of overall income or income per capita, one must look at how

that income is distributed among the population and who benefits from development.

Poverty

The developing countries have been marked by the phenomenon of wide spread poverty. The magnitude and extent of poverty in any country depends on the average level of national income and the degree of inequality in its distribution. There is a wide disparity between developed and developing countries especially among the developing countries. It has been already stated earlier from the World Bank estimates that in the year 2001, 16 per cent of the population in the high income countries receives 81 per cent of the world income, whereas low and middle income countries although have 84.4 per cent of the population they have only 19.2 per cent of the World income. The number of people in extreme poverty (living on less than $1 a day) in the low and middle income countries have risen from 1292 million in 1990 to 1169 million in 1999, that is in the year 1990, 30 per cent of the people in low and middle income countries lived on less than $1 a day. By 1999, the share had fallen to 23 per cent, representing 1170 million people living in extreme poverty. During the same period the population of the low and middle income countries grew by 15 per cent to 5 million and their GDP grew by 31 per cent.

The fastest economic growth and the greatest poverty reduction were found in East Asia and the Pacific, where GDP per capita rose by 75 per cent, while the share of people in extreme poverty fell from 31 per cent to 16 per cent. But in sub – Saharan Africa, where GDP per capita fell by 5 per cent, the poverty rate rose from 47 per cent in 1990 to 49 per cent in 1999 and the number of people living in extreme poverty increased by 74 million. The transition economies of Europe and Central

Asia experienced an even sharper drop in income and their poverty rate has more than doubled. In East Asia and the Pacific, number in Poverty fell sharply from 486 million in 1990 to 279 million in 1999 and similarly in South Asia it fell from 506 million to 488 million and for sub – Saharan Africa it raised from 241 million to 315 million during the same period. The people below poverty line (measured below $1 a day) in 1999 was 49 per cent in sub – Saharan Africa, 36 per cent in South Asia, 15 per cent in East Asia and the Pacific and 11 per cent in Latin America and the Caribbean. The low and middle-income countries as a whole have 23.2 per cent (excluding China that alone has 25 per cent) of population below $1 a day in the year 1999.

Education

The literacy rate in most of the developing countries is meagre. The scope for spreading educational facilities is not quite good and is inappropriate according to the needs of the country. In spite of the good steps taken by the government, the quantitative advances in school enrollment was low compared to the developed countries. The adult literacy rate (percentage 15 and above) in the low income countries has grown from 55 per cent in 1990 to 63 per cent in the year 2001. In the middle income countries, the adult literacy rate (15 and above) has grown from 81 per cent in 1990 to 86.5 per cent in the year 2001. The combined primary, secondary and tertiary gross enrollment in low-income countries has grown from 39.3 per cent in 1980 to 49 per cent in the year 2000. In the middle income countries it has raised from 55.7 per cent in 1980 to 65.3 percent in the year 2000, whereas in the high income countries it raised from 74 per cent in 1980 to 90 percent in the year 2000.

Health

The developing countries not only have a low per capita income and low standard of living but also have to face a constant battle against malnutrition, disease and ill health. The life expectancy in the world rose from 63 years in 1980 to 67 years in 2001. In the low income countries it has grown from 53 years in 1980 to a state of 59 years in 2001. For the middle income countries it rose from 66 years in 1980 to 70 years in 2001, whereas in the high income countries it rose from 74 years in 1980 to 78 years in 2001.

The infant mortality rate in low and middle-income countries declined from 86 per 1,000 in 1980 to 61 in the year 2001. In the high-income countries it has declined from 12 per 1, 000 in 1980 to 5 in 2001. The overall health position in the developing countries is not good due to the lack of proper nutrition, unavailiabity of portable water, medicines and physicians etc.

2. Low Levels of Productivity

In addition to the low levels of living, developing countries are characterized by relatively low levels of labour productivity as compared to the developed countries. They lack managerial competence, quick access to information, workers motivation and institutional rigidity which are the hardships in the way of their progress. Besides they have low saving, low capital formation and know-how etc.

The levels of productivity can be enhanced by raising domestic savings and by mobilizing foreign finance to generate new investment in physical capital goods and to build the stock of human capital through investment in education and training. Institutional changes are also necessary to maximize the potentialities of new physical and human investment. These changes might include such diverse activities as the

reform of land tenure, corporate tax, credit and banking structures, the creation or strengthening of independent, honest and efficient administrative services and the restructuring of educational and training programmes to make them more appropriate to the needs of developing societies.[4]

3. High Rates of Population Growth

The developing countries have a high rate of growth of population. The birth and the death rates are also high in the developing countries. The population is growing at a faster rate than the growth rate of the economy, resulting in a high mass consumption with a little income saved for capital formation. In the low and middle income countries, growth rate of population was 1.7 per cent whereas, the growth rate of the economy was merely 3. 3 per cent per annum during the period 1980-2001. The birth rate for the low and middle income countries per 1000 is 23 whereas, for the high income countries it is mere 12 during the year 2001.

4. High Level of Unemployment

The developing countries are characterized by the Phenomenon of widespread unemployment. The growth of output in such an economy is not accelerating as compared to the growth of population and consequently they have limited means to grow. Due to the prevalence of widespread poverty in these countries, markets for industrial products are small which provides little incentives for industrialists to expand their activities. Faced with the lack of effective demand, industries grow haltingly and offer too few new Job opportunities to the continuously increasing number of working population. The traditional agriculture characterized by low productivity also suffers from lack of labour absorption capacity. Hence, an increasing pressure of population on land

causing disguised unemployment. In the absence of alternative employment opportunities, people stick to live on small pieces of land, which are just sufficient for subsistence living.

5. Dependence on Agriculture

The developing countries are characterized as an agrarian economy. It provides the means of livelihood to the majority of people in these countries. In the low and middle-income countries agriculture accounted for 16 per cent of GNP in 1990, and 12 per cent in 2001. In the high income countries the share of agriculture in GNP was 3 per cent in 1990 and 2 per cent in the year 2001.

The agricultural sector is not properly developed and it is being carried out by traditional tools and equipments. Agricultural production is low not only because of the high pressure of population on land but also due to the availability of primitive technologies, fragmentation of land, poor organisation and limited physical and human capital inputs. It can be characterized by technological backwardness where the most of the produce are non – commercial in nature. In many parts of the world especially in Asia and Latin America, it is characterized further by land tenure arrangements in which peasants rent rather than own their small plots of land. Most of the developing countries produces primary products and are the main exporters of the primary products except for a few countries, which have sufficiently developed their potential to export manufactured goods.

6. Imperfect Markets

In most of the developing countries markets are not perfectly organized. There is a lack of legal and institutional foundations that enforces contracts and validates property rights, a stable and trustworthy currency, an infrastructure of roads and communication outlets, a well

behaved system of banking as to facilitate interregional trade, economic cooperation etc. But since 1980s and 1990s almost every developing country is moving at varying speed towards the establishment of market friendly economies.

2.2 GLOBAL FOREIGN DIRECT INVESTMENT FLOWS AND DEVELOPING COUNTRIES

FDI has played a significant role in the development of the developing economies. It is a large and growing source of equity investment that brings with it considerable benefits, technology transfer, management, know-how and export marketing access etc. It contributes to the growth of developing economies through various channels in addition to physical capital formation, including technology transfer, human capital (management skills) development and promotion of foreign trade. The foreign owned firms stimulate local productivity through backward linkages to service supplies and the labour force and by serving as a model of working practices and management technique. It has been argued that the best measure of the impact of FDI is not simply the initial BOP transactions but also the local purchases of the foreign firms from suppliers and sales to customers in the host market, because these are analogous to exports and imports. The foreign affiliates of transnational corporations can contribute directly to technological advancement in developing countries through a stimulus to research and development expenditures, changes in product and export composition and higher factor productivity. Although, direct employment by foreign owned corporations in developing countries is small (less than one per cent of the workforce), foreign affiliates accounted for more than a quarter of employment in manufacturing industries in a number of

developing countries. This is generally associated with high technological and industrial know-how, such as electrical and electronic equipment, non-electronic machinery and chemicals. This has enabled foreign firms to generate a higher share of manufacturing exports.

Therefore, almost all the developing countries have been trying hard to attract more capital flows. The developing countries have rightly realized that assigning greater role to private sector has become the need of the day and hence, private capital flows role and contribution in accelerating the pace of growth and development have become of strategic importance. The role of private capital flows in developing countries have increased sharply in the past ten years because of higher returns, risk diversification, financial deregulation, advance technology and the availability of diverse financial instruments, all fuelling the globalization of financial markets.

Most of the countries in the world have emphasized on the view that FDI does more good than harm and have forwarded policies that make their home environment more and more attractive for foreign investments.

The number of countries presented in the Table 2.1 below asserts that the number of countries that have changed their investment regimes has increased from a mere 35 in 1991 to as many as 71 in 2001. The number of countries making regulatory changes has also increased from 82 in 1991 to 208 in 2001 and the number of regulatory changes brought about to make FDI more favourable have increased from mere 80 in 1991 to 194 in 2001. In the year 2001, 208 changes in FDI laws were made by 71 countries, raising the total number of annual to its highest level since the world investment report (WIR) began reporting on them. In 2001, out of the total changes 93 per cent created a more favourable investment

Table 2.1
National Regulatory Changes During 1991-2001

Item	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Number of Countries that introduced changes in their investment regime.	35	43	57	49	64	65	76	60	63	69	71
Number of regulatory changes.	82	79	102	110	112	114	151	145	140	150	208
Number of regulatory changes that made FDI more favourable.	80	79	101	108	106	98	135	136	131	147	194

Source: World Investment Report, UNCTAD, 2002, p.7.

climate in an effort to attract more FDI. The Asian and Pacific region introduced the largest number of such changes (43 per cent).[5]

The debt crises in the early 1980s have not only resulted in a decline in the commercial lending to some countries but FDI flows has been also adversely affected. This has resulted in a dramatic decline in the macroeconomic performance and creditworthiness of the developing countries to a sharp increase in the interest rates and recession in the industrialized countries.[6] During the mid 1980s macroeconomic environment started to improve and it became even faster during early 1990s. Moreover, the developing countries that are the major recipients of FDI realized a decline in inflation, higher growth of output and exports and higher and more productive investment. The strong macroeconomic environment reflected a good prospect for foreign investors including the growth of output and exports and the reduction in external liabilities has reduced the country's risks for foreign investors. Many of these countries

have also seen a significant growth in the skilled labour force and improvements in supporting infrastructure over the past decade.

The improvements in economic performance of developing countries have been due to the systematic adoption of macroeconomic stabilization programmes and structural reforms by a growing number of countries and a more favourable international environment. This includes the fiscal adjustment programmes, declining fiscal deficits, trade liberalization and financial sector liberalization which have promoted more private sector activity and outward oriented economies. There was a shift from the inward-oriented FDI in the late 1970s towards exports oriented FDI during 1990s. This reform has reduced the risks and improves the expected rates of return in developing countries. In spite of these, the capital markets in the 1990s have been deepened and broadened. The other features of FDI flows in 1980s and 1990s is that FDI inflows have shifted from manufacturing and extraction to services particularly the new capital intensive service industries such as telecommunications, transportations, banking and public utilities which are being privatized and opened to FDI in several developing countries.

The liberalization of FDI policies by developing countries during 1990s is accompanied by the number of bilateral and multilateral treaties on the promotion and protection of investment. A number of such treaties such as the multilateral agreements on investments as a part of wider multilateral agreements such as the North Atlantic Free Trade Agreements (NAFTA), Multilateral Agreements on Investment (MAI) and even more recently, World Trade Organization (WTO) are such treaties and agreements as to contain the liberalization of the policy framework for FDI.[7]

The break–up of world wide foreign direct investment in major economies is given below.

Table 2.2
Foreign Direct Investment inflows by host region and Economy During 1990-2001

(US $ Million)

Host Economy/Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
World	202782	160199	171199	227532	259696	330516	386140	478082	694457	1088263	1491943	7354146
Developed Countries	164575 (81.2)	113099 (70.6)	107288 (62.7)	137153 (60.3)	14486 (5.6)	203311 (61.5)	219908 (57.0)	267947 (56.1)	484239 (69.7)	837761 (77.0)	1227476 (82.3)	503144 (68.4)
European Union	90213 (44.5)	77735 (48.5)	72343 (42.3)	73428 (32.3)	76833 (29.6)	114439 (34.6)	110376 (28.6)	127919 (26.8)	262216 (37.8)	487898 (44.8)	808519 (54.2)	322954 (43.9)
Developing Economies	37567 (18.5)	44396 (27.7)	59238 (34.6)	83294 (36.6)	108699 (41.9)	112537 (34.1)	152685 (39.5)	191022 (40.0)	187611 (27.1)	225140 (20.7)	237894 (16.0)	204801 (27.9)
Africa	2483 (1.2)	3307 (2.1)	3840 (2.2)	4420 (1.9)	6127 (2.4)	5743 (1.7)	5835 (1.5)	10749 (2.3)	9021 (1.3)	12821 (1.2)	8694 (0.6)	17165 (2.3)
Latin America and The Caribbean	10282 (5.1)	16713 (10.4)	22147 (12.9)	19806 (8.7)	33738 (13.0)	30866 (9.3)	52856 (13.7)	74299 (15.5)	82203 (11.8)	109311 (10.1)	95405 (6.4)	85373 (11.6)
Asia	24251 (12.0)	24272 (15.2)	32965 (19.3)	58716 (25.8)	68509 (26.4)	75217 (22.8)	93331 (24.2)	105828 (22.1)	96109 (13.8)	102779 (9.4)	133707 (9.0)	102066 (13.9)
West Asia	2141 (1.1)	2230 (1.4)	2776 (1.6)	3635 (1.6)	1791 (0.7)	3 (0.0)	2898 (0.6)	5645 (1.2)	6705 (1.0)	324 (0.03)	688 (0.5)	4133 (0.6)
Central Asia	4 (0.002)	20 (0.01)	120 (0.7)	1418 (0.6)	924 (0.4)	1484 (0.5)	2590 (0.7)	3844 (0.8)	3152 (0.5)	2466 (0.2)	1895 (0.13)	3569 (0.5)
South East and South East Asia	22106 (10.9)	22022 (13.8)	30068 (17.6)	53664 (23.6)	65794 (25.3)	73729 (22.3)	87843 (22.8)	96338 (20.2)	86252 (12.4)	99990 (9.12)	131123 (8.8)	94365 (12.8)
Central and Eastern Europe	639 (0.3)	2705 (1.7)	4672 (2.7)	7086 (3.1)	6311 (2.4)	14668 (4.4)	13547 (3.5)	19113 (4.0)	22608 (3.3)	25363 (2.3)	26563 (1.2)	27200 (3.7)

Source: World Investment Report (Various issues) ,UNCTAD

The flows of FDI towards developing countries began to increase in the second half of the 1980s reflecting improved macroeconomic performance (particularly in some Latin American countries, following debt reduction agreements) more favourable regulatory regions (as in Thailand), and active privatization and debt conversion programmes. FDI in developing countries has increased tremendously leaving behind the other flows as a source of external funding for economic development. The share of FDI going to developing countries has increased from a low level of less than 17 per cent in 1987 to 28 per cent in 1991. Two countries, United States and Japan accounted for nearly 75 per cent of the entire foreign direct investment flows to developing countries in 1990. A consequence of source concentration is the so-called triad pattern of foreign direct investment flows (with its regional association) appears to be growing more accentuated. The United States multinationals favour Latin America, whereas Japan and Newly Industrialized Economies (NIEs) are the main source of foreign direct investment in Asia. There has been some growth in intra developing countries flows for example, from Korea to China, for Eastern Europe, the European community is the major source of foreign direct investment.

Global FDI flows as presented in the Table 2.2 shows that the amount of FDI has increased from US $202782 million in 1990 to US $330516 million in 1995 and further to US $735146 million in 2001. The share of developed countries has decreased from US $164575 million that is 81.2 per cent in 1990 to US $203311 million that is 61.5 per cent in 1995 and finally to US $503144 million that is only to 68.4 per cent in 2001. The share of FDI flows to developing countries has been increased from US $37567 million that is 18.5 per cent in 1990 to US $112537

million that is 34.1 per cent in 1995 and further to US $204801 that is 27.9 per cent in the year 2001.

The distribution of FDI flows to the developing countries and economies in transition has been quite uneven. The developing Asian region is now the most important developing country in the region in terms of FDI having overtaken Latin American and the Caribbean economies. The recent investment flow figures show that the region is further building its lead. This is reflected by Asian countries better performance among developing country regions in terms of GDP and export growth rates as well as the ability to control and manage indebtedness. This has made developing Asia, particularly the East and South-East Asian region as the largest recipient of FDI among developing countries. A substantial part of the fast growing FDI inflows are interregional. Among the developing countries China continued to be the largest absorber of FDI. Among the South-East Asian economies FDI have sharply declined for Indonesia and Malaysia and also experiencing a downward trend. The Republic of Korea however has experienced a decline in the volume of FDI flows in the year 2000 and 2001. The inflow of FDI to developing countries in 2001 was US $204801 million in which US $102066 million 27.9 per cent went to developing Asia (including Central Asia and West Asia) and US $46840 million to China alone. Latin America and the Caribbean received US $85373 million, 11.6 per cent in the year 2001. The countries of Central and Eastern Europe in transition towards a market economy attracted US $27200 million that is merely 3.7 per cent of the total FDI flows in the year 2001.

2.3 SAVING - INVESTMENT GAP AND FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES

In the early stages of development, there is a need to ensure sustained and high rates of economic growth through relatively high rates

of investment. But the high rates of economic growth are not accompanied by the high rates of domestic savings. In a completely open international economic setting with full capital mobility, one may not be able to observe a perfect correlation between domestic saving and investment. Hence, FDI is required as to fill up the gap, generated by the mismatch of domestic saving and investment.

An outline of the saving – Investment behaviour as a percentage of GDP is presented in the Table 2.3 below. The Table shows that in the world economy saving as a percentage of GDP rose from 23.1 per cent in 1994 to 23.4 per cent in 2000, whereas investment as a per cent of GDP was stabled at 23.8 per cent during the above mentioned period. In the US economy saving rate has increased from of 16.4 per cent in 1994 to 17.3 per cent in the year 2000, whereas the investment rate as a percentage of GDP was 18.8 and 21 per cent respectively during the above mentioned. European Union has a saving rate of 19.8 per cent in 1994 and 21.7 per cent in 2000 with investment rate of 19.7 per cent and 21.3 per cent for the same period. The saving rate in Japan was high at 33.5 per cent in 1994 and 28.8 per cent in 2000, with an investment rate of 28.7 per cent and 26.6 per cent respectively.

The saving rate in the newly industrialized Asian economies rose from 33.6 per cent in 1994 to 33.7 per cent in 2000, whereas the investment rate has reduced from 31.9 per cent to 27.6 per cent during the aforesaid period. The Asian economy in general has observed a high saving rate of 33.4 per cent of GDP in 1994 and 31.8 per cent in 2000 with an investment rate of 33.9 per cent and 30.3 per cent respectively.

The table shows that in the Asian economies especially, the newly industrialized economies have high saving as well as the investment rate. However, the rate of saving and investment for the developing countries are not satisfactory. The various studies so far carried have a general view that the saving rate can be increased by reduction of poverty and

Table 2.3
Saving and Investment as a Percentage of GDP During 1978-2000

Region or Economy	Averages								
	1978-85	1986-93	1994	1995	1996	1997	1998	1999	2000
World									
Saving	23.3	22.8	23.1	23.2	23.3	23.9	23.2	23.2	23.4
Investment	24.4	24.0	23.8	24.2	24.0	24.1	23.3	23.2	23.8
U.S.									
Saving	19.7	16.9	16.4	17.0	17.3	18.3	18.8	18.7	17.3
Investment	21.2	18.9	18.8	18.7	19.1	19.8	20.5	20.7	21.0
Net Lending	-1.5	-2.0	-2.4	-1.7	-1.8	-1.5	-1.8	-2.1	-3.8
European Union									
Saving	20.7	20.4	19.8	20.6	20.4	21.1	21.3	21.1	21.7
Investment	21.5	21.2	19.7	20.0	19.4	19.7	20.5	20.9	21.3
Net Lending	-0.8	-0.9	0.1	0.5	1.0	1.4	1.8	0.2	0.4
Japan									
Saving	31.2	33.1	33.5	30.7	31.5	31.4	29.9	28.7	28.8
Investment	30.1	30.4	28.7	28.6	30.0	29.1	26.7	26.1	26.6
Net Lending	1.0	2.7	2.8	2.1	1.5	2.3	3.2	2.5	2.1
Developing Economies									
Saving	22.5	23.4	26.6	26.3	26.5	27.1	25.9	25.4	26.2
Investment	24.0	25.4	27.9	28.7	27.7	27.6	26.3	25.7	26.2
Net Lending	-1.5	-2.0	-1.3	-2.5	-1.2	-0.5	-0.4	-0.3	
NIEs (Asia)									
Saving	-	35.6	33.6	33.7	32.8	32.7	33.3	32.9	33.1
Investment	-	29.9	31.9	32.7	32.2	30.8	23.4	25.3	27.6
Net Lending	-	5.7	1.8	1.1	0.6	1.9	9.9	7.5	5.5
Asia									
Saving	25.1	28.7	33.4	32.0	32.5	33.4	32.6	31.6	31.8
Investment	26.1	30.7	33.9	34.6	33.5	32.4	29.9	29.7	30.3
Net Lending	-1.0	-1.4	-0.4	-2.7	-1.0	1.0	2.8	1.9	1.5

Source: World Economic Outlook, IMF, 2001.

dependency burden, growth in per capita income, financial sector development, real interest rate and the fiscal stance of the governments are important determining factors.

Foreign investment (as well as foreign aid) is typically seen as a way of filling in gaps between the domestically available supplies of

savings, foreign exchange, government revenue and the desired level of these resources necessary to achieve growth and developmental targets. Therefore, the first and most often cited contribution of private foreign investment to national development (i.e. when this development is defined in terms of GDP growth rates – an important implicit conceptual assumption) is its role in filling the resource gap between targeted or desired investment and locally mobilized savings.[8] Foreign capital has a favourable effects on capital formation when it takes the form of green field investments rather than that of merger and acquisitions. This depends to a larger extent on counter factual situation and also on domestic economic policy more than on whether the foreign investment represents an immediate addition to the country's capital stock.

In recent years, the role of foreign direct investment in stimulating growth process, particularly in developing countries has increasingly been emphasized. The two main arguments have been advanced in support of this view. The first, essentially a short-term view, maintains that foreign direct investment can help in mitigating problems encountered in external debt management. The second takes the longer-term perspective while arguing that foreign direct investment has the potential of meeting the domestic resource gap of developing countries thereby enhancing their growth.

The long-term view of benefits arising out of foreign direct investment is based on the perception that such inflow of capital acts as an engine of growth in developing countries. It has been argued that foreign direct investment by raising the levels of capital formation in host countries, significantly contributes to the country growth processes.

Foreign direct investment according to this view is seen as an important source of foreign savings for the host countries, which augment their domestic resources available for investment.[9]

The relationship between foreign direct investment flows and saving-investment behaviour of host countries is analysed for the sample countries with the help of a simple statistical exercise. The relationship between foreign direct investment and investment behaviour is worked out by taking the figures of gross inflows of foreign direct investment and the gross fixed capital formation.

The Table 2.4 below depicts the relationship between FDI and gross domestic Investment in the context of a number of countries. The position of developing countries in the world is relatively weak as their percentage share has been increased from 4.4 per cent in 1991 to 12.7 per cent in 2001, whereas for the developed countries it has increased from 3.2 per cent in 1991 to 12.7 per cent in the year 2001. Hong-Kong has secured a good position as its share has been increased from merely 2.3 per cent in 1991 to 54.2 per cent in the year 2001. Singapore is the only country in the world which has maintained a better position as its share has been increased from 33.6 per cent in 1991 to 43.8 per cent in the year 2001. It is followed by Thailand whose share has increased from 4.9 per cent in 1991 to 14.4 per cent in the year 2001. Malaysia's position in FDI flows. as a percentage of gross domestic investment is weak as its share has decreased from 23.8 per cent in 1991 to 2.5 per cent in the year 2001.

Table 2.4
Inward Foreign Direct Investment as a Percentage of Gross Domestic Investment During 1985-2001

Region/ Economy	1985-1990 (Averages)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
World	5.4	3.1	3.3	4.4	4.5	5.3	5.9	7.5	10.9	16.5	20.8	12.8
Developed Countries	5.5	3.2	3.2	3.7	3.5	4.4	4.8	6.0	10.4	17.1	22.9	12.7
Developing Countries	8.0	4.4	5.1	6.6	8.0	7.7	9.1	11.4	12.0	14.3	14.6	12.7
Hong Kong	12.2	2.3	7.7	7.1	8.2	14.6	12.7	19.5	29.4	58.6	138.9	54.2
China	14.5	3.3	7.8	20.0	24.5	14.7	14.3	14.6	13.1	11.3	10.3	10.5
Indonesia	7.6	3.6	3.9	3.8	3.7	7.6	9.2	7.7	-1.5	-9.7	-14.3	-10.8
Malaysia	43.7	23.8	26.0	22.5	16.1	15.0	17.0	14.7	14.0	22.2	16.5	2.5
Singapore	59.3	33.6	12.4	23.0	23.0	31.2	29.7	37.0	24.7	47.6	45.6	43.8
Thailand	10.2	4.9	4.8	3.4	2.3	2.9	3.0	7.6	29.9	23.8	12.4	14.4
India	1.2	0.3	0.4	1.0	2.4	2.4	2.9	4.0	2.9	2.2	2.3	3.2
Taiwan	5.1	3.1	1.8	1.8	2.5	2.4	3.0	3.4	0.4	4.4	6.8	7.8
Republic of Korea	1.9	1.0	0.6	0.5	0.6	1.0	1.2	1.7	5.7	8.3	7.1	3.1

Source: World Investment Report (Various issues), UNCTAD .

There has been a mixed opinion about the capital inflows, savings and investment relationship. In the 1990s large capital inflows into several developing countries have not generally led to increase in total investment. In fact, in many countries that have experienced surges of foreign capital, have remained unchanged and domestic saving has fallen (Alison and French Davis, 1996).

2.4 FOREIGN EXCHANGE AND FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES

Foreign exchange is in the form of currency, which is used in making international payments. The mechanism through which payments are made between two countries or more having different currency system is called foreign exchange. It may be defined as the exchange of money or credit of one country with money or credit of another country. It includes foreign bill of exchange, drafts and telegraphic transfers and letters of credit etc. The rate at which currency of a country is being exchanged for another currency is called foreign exchange rate. The rate of exchange, being a price of a national currency in terms of another is determined in the foreign exchange market in accordance with the general principle of the theory of value i.e. by the interaction of the forces of demand and supply.

The buyers and sellers of claims on foreign money and the intermediaries together constitute a foreign exchange market. Thus, foreign exchange market is the market for a national currency anywhere in the world, as the financial centers of the world are united in a single market.

The demand for foreign exchange arises on account of the country's import of goods and services, investment in foreign countries

and other types of payments involving international transfers. On the other hand, the supply of foreign exchange depends on the country's export of goods and services, investments of foreign countries in that country and other receipts from the rest of the world.

The developing countries are in the initial stages of development. They have to go for heavy imports to pave the way for rapid economic development. For this purpose they need machinery, equipment, industrial raw materials and know-how etc. These countries lack potential savings and capital and also have insufficient amount of exports. So, they are burdened with heavy imports and have to bear deficit in their BOP. The lack of potential savings and capital formation makes them depend upon foreign capital. The foreign liabilities with a mounting rate of interest worsen the BOP further. Similarly, these flows raise domestic spending power and demand for both traded and non-traded goods thus by worsening both the competitiveness and trade accounts. So, the rising imports and lagging exports lead to widening of the deficit in the current account and on the capital account causing BOP to be unfavourable as developmental programmes get momentum.

The export promotion and import substitution programmes can help these countries to overcome such problems. Foreign capital in the form of foreign direct investment can help them not only to adjust their capital account of BOP but also to stabilize their foreign exchange reserves. The inflow of foreign capital along with machines and equipment, better management, know-how etc helps them to expands their industrial base. These steps strengthen their productive capacity to produce import competitive goods and qualitative export goods. Cheap and better goods enable them to earn appropriate amount of foreign exchange and to stabilize the external value of their currency. Thus, if

capital flows are directed towards the production of export goods than the supply of traded goods will improve the trade account. If capital accumulation is directed towards the non-tradable sector (domestic utilities etc.) instead, then the trade account will deteriorate and the real exchange rate will tend to depreciate, as price of non-tradable will tend to fall. Though, the gradual improvement in price levels will eventually pull resources towards tradable and in doing so will restore equilibrium on the trade account.[10]

Although, one of the important contributions of foreign direct investment is towards filling the gap between targeted foreign exchange requirements and those derived from net export earnings plus net public foreign aid but its long run impact may be to reduce foreign exchange earnings on both current and capital accounts. The current account may deteriorate as a result of the substantial importation of intermediate products and capital goods and the capital account may worsen because of the overseas repatriation of profits, interest, royalties, management fees and other funds.[11]

The developing countries may design their policies as to take maximum benefits and can pursue checks and balance such as limiting the importation of goods necessary for production, restricting the repatriation of capital up to book value and tax profits and so on.[12]

2.5 FOREIGN DIRECT INVESTMENT AND BALANCE OF PAYMENTS OF DEVELOPING COUNTRIES

The principal tool for the analysis of the monetary aspects of international transactions is the balance of international payment statements or simply the BOP. The BOP of a country is the systematic

record of all the economic transactions of a country with the rest of the world during a given period of time.

The transactions presented in the BOP are current account and capital account. The current account includes the merchandise trade of goods imported, exported and invisible trade such as foreign travel, transportation, insurance, banking, interest and dividend and government expenditures on embassies etc. The capital account covers the short-term and long-term capital flows. They are both in the form of direct investment (equity participation) and portfolio investment (stocks and bonds) etc. These flows meet the needs of business households and individuals and official flows for meeting BOP needs and debt obligations etc and banking flows are needed for business purposes in the international financial markets.

In addition to the current account and capital account there is also the official reserves account. In principle, this is not different from the capital account and is related to financial liabilities. However, in this category only "reserve assets" are included. These are the assets, which the monetary authority of a country uses to settle the deficit and surplus that arise on the other two categories taken together.

The BOP is always said to be in balance in the accounting sense or double entry book – keeping sense. This is because two aspects (debits and credits) of each transaction recorded are equal in amount but appear on the opposite sides of the BOP account. In this accounting sense, BOP of a country must always be in balance.[13]

A balance in double – entry book keeping sense does not necessarily imply equilibrium in real economic sense. Thus, when we speak of disequilibria in the BOP, we refer not only to the BOP as a whole but also to the balance in certain categories or sections of credit

and debits in the structure of BOP. Kindlerberger puts "while total credits equals total debits in the BOP, a number of partial balances have been devised to indicate the degree of approach to equilibrium.

Basically, a BOP account is compiled to measure gross deficits or surplus with the rest of the world. However, the BOP statements has become increasingly important in recent years as it has been devised to describe in a concise fashion the state of international economic relationship of the country as a guide to its monetary, fiscal, exchange and other policies. It offers a major control tool for both analyzing and directing a country's international economic position. Thus, the fundamental aim of the BOP is to inform governmental authorities about the international economic position of the country, assist them in reaching decisions on monetary, fiscal policies, foreign trade and foreign exchange phenomena.

The BOP analysis shows whether a country is paying its way internationally, whether it is paying for its imports and other current payment transactions by exporting goods, drawing down its foreign assets, accumulating foreign liabilities or receiving donations. Thus, whether a country is borrowing or lending money, whether its currency and foreign exchange resources are stronger and how effective are the monetary and exchange control policies it pursues can be studied from the BOP statements of a country. The BOPs accounts also permits an appraisal of the effects of currency devaluation i.e. whether exports have increased to a considerable extent through devaluation or not can be easily seen from the current account sections of the BOP statements.

The developing countries are on the track of developmental process. They have low saving, low capital, insufficient know-how and management etc. So, they require a sufficient amount of capital, better

know-how and management to overcome these bottlenecks. This comes as an effective instrument in the attainment of other objectives of economic policy such as faster rate of economic growth, full employment with a direct and indirect bearing on the BOP. Therefore, the BOP question is more pressing for the developing countries than the developed ones. In the developed countries foreign exchange requirements vary according to the country and period but in the developing countries foreign exchange is regarded as the scarce factor inhibiting growth. Consequently, any effects such as those arising from foreign direct investment, which mitigate or worsen these BOP limitations on the attainments of certain objectives, assume a significance of their own.

The evaluation of the effects of foreign direct investment on the BOP of the host country takes the form of examining the physical and financial aspects of the operations of foreign firms on that country. Since, such effects are of both direct and indirect type one must examine the impact of foreign firm operations in terms of (a) their absorption of the host country's factor inputs in the production process (b) the proportion of their output sold in the host country's market and abroad (c) the distribution of the value of their output between the host countries factor inputs and between the host government in the form of tax and revenues share.[14]

The effects of inward investment on the BOP can be distinguished between an initial one and for all effect and the continuing one's arising because the subsidiary is under foreign ownership and management. The effects seem to be by far the most important ones. The initial effect seems to improve the capital account of the BOP of the host country by the amount of the investment, less the value of any imported real capital (machinery). The repercussions of the operation of foreign firms on the

BOP of the host countries can be known by having a look on the inward investment and that of a take over of a domestic firm.

In the first case foreign investor imports some real capital, which is used to produce goods, or alternatively he imports financial capital that in turn is expected to finance the purchase of real capital abroad. In this situation, the initial effects on the BOP are zero. However, as a result of this operation the capital stock of the host country will increase and consequently there will be an increase in the production of domestic output. This increase in output due to inward investment affects BOP both directly and indirectly. The direct influences take the form of the various remissions to the home country, such as management fees, royalties, profits and capital repatriation as well as the effects of import substitution, export promotion depending on the nature of investment and import content of the output of the subsidiary etc. Indirectly, the BOP is affected through the effects that the increased flow of domestic output has on domestic factor incomes and aggregate demand. With the given propensity to import, the increased domestic incomes interact with imports positively and therefore, affect the BOP. When foreign direct investment takes the form of a takeover of a domestic firm, then the initial effects on the BOP equals the price paid for that firm's acquisition. However, since the takeover does not entail changes in the availability of resources, the flow of output does not change provided one assumes the same utilisaiton of existing resources before and after that take over. Nevertheless, even under this strict assumption, the BOP is influenced directly because of the remissions to the home country and the export behaviour of the new foreign management and also indirectly through the changes in the incomes accruing to residents. Thus, the indirect macroeconomic effects on the BOP are those arising from the changes in

the income of the residents on account of the operations of the foreign firms, changes in the consumption patterns, induced by advertising and other promotional expenditures of these firms and the consequent effects that these changed consumption pattern may have on the BOP. The effects of inward investment on the BOP of host countries are likely to be beneficial, not only because of the import substitution (or export promotion) and lower import content, but also because of the ability of such host countries to keep for themselves a large share of the value of output of multinational firms in the form of factor incomes and taxes and the fact that the foreign production and its practices may blend without distorting consumption patterns at least to a great extent.

Thus, these effects can be classified into the broad categories of the export effect, the import substitution effect, the import effect and the remission effect. The first two of these effects lead to an improvement in the BOP, while remaining two worsen it. Therefore, the total impact of the operations of foreign firms on the BOP of the host countries is the sum of the individual effects, which can be established on empirical ground for the specific country than on a prior reasoning.

The BOPs of developing countries seems to be benefiting from foreign direct investment in extractive industries, though by no means in all such investments than in manufacturing. This can be explained by the monopoly power conferred upon these countries from the existence of exhaustible natural scarce resources in relatively high demand. Investments in manufacturing seems to have detrimental effects on the BOP of such countries mainly because of the high content of such investments and the mechanism of transfer pricing for multinational firms. Transfer pricing is of course practiced in inter-affiliate transactions involving subsidiaries in developed countries as well. The scope of such

practices is limited by the lack of stringent controls on profit repatriation, tax differentials and the existence of the better monitoring mechanisms. The high import content of the output of multinational firms explained not only the nature of such firms, which explains the import contents of the presence in the output produced in the developed host countries, but also because of the unavailability of locally produced goods, materials, competent, the uncompetitiveness of local prices and inferior quality.[15]

Although, the direct effects of foreign direct investment can be estimated to certain extent, but the indirect effects of the operations of foreign subsidiaries on the BOP of host countries is significant to evaluate, but at the same time very difficult to estimate, as they depend on different assumptions as to how the operations of foreign subsidiaries affect the consumption patterns of the host country.

2.6 FDI AND TRADE FLOWS IN DEVELOPING COUNTRIES

FDI has a pivotal role in the international trade. A study suggests that MNCs export less engineering products than domestic firms while some others argues that their exports were stagnant (Solomon and Ingham, 1977; Panic and Joyce, 1980). Recently it has been observed that FDI directed into developing countries affects their trade flows with industrial countries even after controlling for the effect of the exchange rate (Golberg and Klein, 1997). There is also some evidence indicating that subsidiaries tend to import parts of capital equipment from the parent MNCs that is located in the home country. FDI by influencing trade can effect the overall production and consumption of exportables and importables, which are of critical importance for the pro-trade or anti-trade bias.

The trade can be either substitutes or complements, depending on the basis of international production and exchange rate and on the relevant type of FDI i.e. market-seeking, labour- seeking, resource-seeking and component-outsourcing FDI. In general, market-seeking FDI tends to be import substituting and thus tends to have an anti-trade production bias as it reduces the need for importable.

However, the increase in employment and incomes is expected to increase overall consumption of importable and thus create a pro-trade consumption effect. FDI for the purpose of using the home country as an export platform tend to have pro-trade production and consumption effects.

Labour-seeking FDI takes place for the purpose of using the country as an export base for unskilled labour intensive commodities and for organizing production on a more efficient basis. FDI is associated with pro-trade production and consumption effect as production of exports and consumption of imports are expanded. Resource extraction can have a pro-trade or anti-trade net bias depending on whether it increases exports by more than it reduces imports. In this case, the production and consumption effects are probably biased on opposite directions and the total effect cannot be easily predicted (Chacho Liades, 1978). Component-outsourcing FDI on the other hand tends to have both Pro-trade production and consumption effects as some components are imported, assembled and re-exported from the host country. The same can be said for the exchange of differentiated products, which has pro-trade effects both on the production and consumption.

FDI has both direct and indirect effect, on the one hand resources extracting, labour-seeking or component-out sourcing FDI influences trade directly as TNCs activities give rise to production and exchange of

commodities across borders. For example, FDI in resource extraction give rise to imports of machinery and to export of raw materials. Similarly, assembly based on component out-sourcing FDI usually induces exports of capital goods and / or intermediate products and exports of other intermediate or final consumer goods. On the other hand, FDI has indirect microeconomic and macroeconomic implications for the host country concerned. More specifically, FDI affects the structural competitiveness of domestic firms, the business environment, the market structure and finally national competitiveness as a whole.[16]

In these cases FDI is associated with significant pro-trade externalities that involved " knowledge transfers" as well as " organizational economies" usually through the provision of upstream and downstream business services. FDI into more technologically advanced sectors increases the productivity of capital invested in the country and induces both process and product innovation. As industrial process becomes more efficient or new goods and services are introduced, the volume of exports relative to imports as well as productivity in the traded-goods sector of the economy are expected to increase. Similarly, FDI in services, if integrated properly in the host economy's productive system, enabling existing domestic firms to upgrade not only their own production but also their distributions and marketing networks.[17]

FDI in services critically affects the host country's absolute advantages and competitiveness in two ways (a) it raises the productivity of the capital and enables host countries to attract new capital under more favourable terms, thus shifting the basis of international production in their favour and (b) it can be used as a strategic inputs by the host countries traditional export sectors to expand the volume of trade as well as to upgrade production through process and product innovation.

Furthermore, the presence of foreign firms increases competitive pressure in the domestic market, facing domestic firms to reduce mark-up to modernize their operations and to produce more efficiently. The presence of FDI thus alters both the business environment and the market structure. FDI also affects trade and competitiveness indirectly through its effects on the level of domestic activity notably employment, income, consumption and domestic prices in the host country. The effects of capital accumulation on the volume of trade depends on the combined behaviour of consumption and production in the economy.

This can significantly affect the volume, type and pattern of world trade. The underdeveloped countries in dearth of capital and technological know-how are unable to exploit their natural resources and the need of the people are not fulfilled. This is why the developed nation invests its capital in such nations to get heavy economic return.

Similarly, FDI enables firms to establish a large distributional base, thus enlarging the choice of products sold in the foreign market over and above what could be achieved via exports. Moreover, production in the foreign market invariably requires the import of intermediate products from the home country (and hence exports). The same argument goes for imports by the home country. If a foreign subsidiary can produce goods more cheaply abroad and export them to the home country then obviously it means that FDI leads to increasing imports by the home country. The available empirical evidence is mixed. Most empirical studies based on cross-sectional industry and firms level data indicate a positive relationship. For example, Lipsey and Weiss (1981,1984) and Blomstrom et al (1988) found a predominantly positive relationship. Empirical study on the relationship between trade and FDI indicate complementarily (Belerbos and Sleuwaeger, 1988). He attributed his findings to

aggregation bias and shows that the substitution effect is easy to identify in product level data. Finally, the study asserts that the FDI flows depend upon the nature and partially on the country specific characteristics (Amitiet and et al, 2000).

2.7 THE IMPACT OF FOREIGN DIRECT INVESTMENT FLOWS ON THE DEVELOPING COUNTRIES

FDI involves the transfer of financial capital, technology and other skills (managerial, marketing, accounting etc.) and benefits the countries involved. Generally, the effects of FDI can be placed in economic, social and political categories. The presumption that is found in the literature which is based on the principles of Neo-classical economies is that FDI raises income and social welfare in the host country until the optimum conditions are significantly distorted by protection, monopoly and externalities (Lall and Streeten, 1977).

The political and social aspects of FDI were no doubt very important and deserve close analysis and examination. The political effects include the question of national sovereignty as the sheer size of the investing MNCs may jeopardize national concerns. The social issues are mainly concerned with the creation of enclaves and foreign elite in the host country as well as the cultural effects on the local population (for e.g. customers and traders). Naturally, social issues are more likely to arise when there are significant economic, social and cultural differences between the investing and host countries.

The economic effects of FDI can be distinguished into macro and micro ones. Macro effects can further be divided into primary and secondary linkages. Primary linkages are associated with growth, output, employments, BOP (foreign exchange, trade), productivity, technological

know-how, training of labour and management etc. On the other hand, secondary linkages are essentially inter-industry linkages and are related to the way in which FDI integrates with the local economy through local markets, locally produced materials and components. This is case with most of the services sector, such as banking, insurance and brokerage, following in the wake of the manufacturing and mining sectors but also of foreign suppliers of components and materials to those sectors. The micro influences of FDI are related to structural changes in economic and industrial organisation. They have to do with the creation of a more competitive environment or conversely with the worsening of monopolistic and/or Oligopolistic elements in the host economy.[18]

2.7.1 The Effects of FDI on Output and Growth

FDI exerts a significant role in the output and growth of the developing countries. The effects of FDI on the level, composition and growth of output of the host country depends to a large extent on the macroeconomic policy in operation in that country. In general it seems that FDI can exert an impact on the output of the host country if it is possible to absorb surplus resources and / or improve efficiency through alternative allocations.[19]

The extent to which FDI can affect the level and composition of national output and its growth could be gauged with reference to alternative assumptions regarding macroeconomic policy pursued by the host nation. If the government moves according to demand, proper management could always help to achieve full employment of resources and cause inward investment not to affects the size of the national product. This is comparable to alternative patterns of resource utilisation, provided foreign investment is efficient as domestic means of resource utilisation. But if inward investment absorbs resources which will have

otherwise remained unemployed then the net output generated by FDI (less and remissions) represents a net gain to real output for the host nation. Similarly, if inward investment improves the efficiency of domestic resources either by shifting them from less efficient to more productive sectors of the economy or by raising their productivity in their existing uses then again domestic output would grow. Therefore, it seems that FDI can exert pronounced influences where it is possible to absorb surplus resources and / or improve their efficiency through alternative allocations.[20]

FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investment provided the host country must have a minimum threshold stock of human capital. FDI has the effect of increasing total investment in the economy more than appropriately, which suggest the predominance of complementarity's effects with domestic firms.

Lall and Streeten, argue that the domination of a developing economy by MNCs may be economically detrimental to growth and development for at least three reasons. First, the activity of MNCs may lead to a lower rate of accumulation domestically because a proportion of the profits generated by this activity is repatriated rather than invested in the host country. Second, the presence of MNCs may lead to some adverse developments such as greater incidence of undesirable practice (for e.g. derogatory transfer pricing) or weaken control over economic policy. Third, the MNCs may adversely affect the market structure making it less competitive.

2.7.2 The Effects of FDI on Employment and Wages

The effects of FDI on employment and wages depend on a great extent on the macroeconomic policy of the host nation and particularly

the "opportunity cost" of inward investment. In the General Theory 1936, Keynes rehabilitated Adam Smith when he conceptualized the direct relation between the investment and employment and concluded that employment can only increase pari passu with an increase in investment unless indeed there is a change in the propensity to consume.[21] The level of employment depends on the (1) the extent to which FDI substitutes for domestic investment, (2) the extent to which FDI stimulates increase of exports of intermediate goods and capital goods and, (3) whether FDI involves the construction of new plants or simply the acquisition of existing facilities. In general, the employment effect of FDI may be summarized as follows:

(a) FDI is capable of increasing employment directly by setting up new facilities or indirectly by stimulating employment in distribution.

(b) FDI can preserve employment by acquiring restructuring ailing firms.

(c) FDI can reduce employment through investment and the closure of production facilities.

They also examined the impact of FDI on the share of skilled labour in total wages in Mexico during the period 1975-1988. The results they obtained indicated that growth in FDI is positively co- related with the relative demand for skilled labour.[22] The analysis of the effect of inward FDI on the British labour market indicates that FDI leads to an increase in wage inequality and the use of relatively more skilled labour by local firms (Taylor, 2000).

2.7.3 The Effects of FDI on Productivity

The effectiveness of FDI in increasing productivity and decrease in the costs depends on the extent of mechanization, capital intensity, size

of the market and the policies of the host countries. The productivity is likely to be increased and the unit cost of production to be decreased if the inward FDI is export promoting provided that the products of the subsidiary are destined for the large world markets and the marketing policies and organisation of the parent company as the size of the market will allow the installation of plants designed to achieve the full economies of scale. On the other hand, if FDI is import substituting and the size of the market is too small to allow the installation of the optimum plant size, productive efficiency may not be achieved. The unit cost of operating a plant smaller than the optimum plant size is not significantly higher than those of most efficient scale. Secondly, even if investments are mainly import-substituting, any scope for some exports leads to an increase in the size of the market and allows the utilisation of a higher per capita intensity technology.[23] Productivity is likely to be affected by the host of other factors which includes the full utilisation of the firm resources, the quality of existing manpower and the industrial climate, the effectiveness of the trade unions and the respective policies. Similarly, the willingness of the management to initiate innovative activity in the area of the industrial relations can greatly improve productivity and ultimately the performance of firms. The workers are also attracted by higher pay and improve better working conditions.

2.7.4 FDI and Technology

The transfer of technology has played an important role in economic development, accumulation of capital, trade and even changes in the organisation of social relations. The major emphasis in this respect is on foreign technology transferred and absorbed by the host country and how it affects a country economy. The appropriateness of technology with respect to the products that are made with the technology and factor

endowments in the host countries. Winter (1991) agrees with his argument by stating that MNCs frequently pass an old technologies which can be too capital intensive for the local economy. Such a technology transfer according to winter's would create a "dualistic structure" in the host country containing a small advanced industrial sector linked to the outside world surrounded by a large capital intensive in relation to the factor endowments in the host country then technology transfer would result in (i) worsening employment (ii) worsening income inequality (iii) distorting influences on the technology used by other firms and (iv) bias in production towards sophisticated and differentiated products.

The adoption of the technology should be in line with (i) the need to scale down the volume of production in keeping with the size of the local markets; (ii) the difficulty of achieving and maintaining acceptable standards of quality control and (iii) the local customs and legal regulations of host country.

2.7.5 FDI and Training

The inward FDI is also linked with the training of local people. Therefore, the multinationals have to incur expenditures on training of local personnel as a part of the initial investment. The foreign subsidiaries can rely on expatriate's personnel at least at the beginning of operations they have a strong incentive to limit the number of such personnel working in the host countries and so they start using the locals as soon as possible. This is partly due to cost considerations, since the remuneration of an expatriate tends to be higher than that of a local employee. [24] Using locals may also be having pressure from the host governments. It is difficult to know the impact of FDI on training of local personnel and the appropriate combination of local and foreign personnel is difficult to know. Reuberetal 1973, reached on the conclusion that even allowing for

the fact that training costs could not properly identified, costs of training locals are not large enough to make a significant contribution to the improvement of the skills of locals.

2.7.6 Inter Industry Linkages and FDI

FDI influence the economies of the host country via inter industry linkages. To the extent that foreign subsidiaries establishes links with local suppliers of locally produced materials and parts, FDI can help to provide local firms with increased opportunities that in turn affect their employment and income positions which may be called as backward linkages. The forward linkages can be forward for distribution purposes.[25] Most of the MNCs operating abroad in the manufacturing sector are sufficiently vertically integrated or have the incentives to engage in inter subsidiary transactions that limit the scope for developing strong and extensive ties with local supplier. Risk considerations may indicate that extensive ties are imprudent, while the state of industrial relations in certain host countries may be particularly significant in this respect. Also for the subsidiary to minimize risk there is the option of takeover of the local suppliers.

2.7.7 The Effects of FDI on Market Structure

FDI can affect the host economy depending on the market structure and its motivation. It is likely to affect the structure of the industries it is directed to and it may be responsible for improving the competitive forces or conversely for worsening the monopolistic or Oligopolistic elements in the host economy.[26] It is argued that the entry of a foreign subsidiary into local markets can force more active rivalry and an improvement in performance than would a domestic entry at the same scale (Caves, 1971). This is because FDI is thought of as a vehicle for disseminating the transfer of technology, including a higher level of

technical efficiency. The OECD guidelines for MNCs with the objective of encouraging behaviour, that is conducive for boosting competition. According to these guidelines, MNCs should (i) refrain from entering into or carrying out anticompetitive agreements such as price fixing (ii) conduct their activities in the manner that is inconsistent with local competition laws and (iii) cooperate with the competition authorities.

The allocative function of the FDI is significant in increasing competition in the host country. Kindlerberger (1969), suggest that the main impact of FDI is widening the scope for competition. This is because, foreign subsidiaries backed up by strong parents can compete efficiently with local oligopolists and break the latter's grip on local market. By reducing monopolistic/oligopolistic distortions, FDI can improve the allocation of resources in the host country.

2.7.8 FDI and Environment

The inward FDI also have a significant impact on the environment of the country. Due to their giant financial, political and negotiating power even on the cost of damage to the environment they are being invited by the developing countries. MNCs choose to locate their production facilities in developing countries because these countries are less stringent to have an environment damage requirements. Indeed, the government of these countries may even inflict damage on the environment as an incentive to attract FDI.

A study on the proposed FDI and environment has been conducted by the OECD 1999, which explores the role of host countries in developing and implementing coherent policies to ensure that proposed projects are environmentally sound. It also considers the strengths and weaknesses of voluntary environmental management. Further, the OECD has put forwarded the argument that FDI can be either "a boon or bane

for the environment" depending on the specific circumstances. It seems, however that FDI is a boon for the environment in a developed country and a bane for the environment in a developing country. The OECD also pointed out some guidelines for how MNCs should tackle environmental issues. The OECD urges MNCs to take due account of the need to protect the environment, public and safety and to conduct their activities in a manner contributing to the wider goals of sustainable development. Specifically, the OECD guidelines on the environment encourages MNCs interalia to (i) provide information on the potential environmental impact of their activities (ii) consult with the communities directly by the environmental policies and (iii) maintain contingency plans for preventing, mitigating and controlling environmental damage.

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CHAPTER-3

Chapter-3

FOREIGN DIRECT INVESTMENT FLOWS IN SELECTED ASIAN COUNTRIES

3.1 FOREIGN DIRECT INVESTMENT IN CHINA

3.1.1 Government Policy

China is now one of the most open economies of the world. Since the inception of its economic reforms in late 1978, it has achieved impressive results including rapid economic growth, major structural changes and unprecedented improvements in the living standards of its people. In spite of its challenging, political, social and economic conditions, Chinese economy is growing rapidly. In pursuance of the economic reforms and strong macroeconomic variables it has attracted the bulk of FDI, which has made China as one of the fastest growing economies on the globe.

The third plenary session of the eleventh central committee of the Chinese Communist Party, which took place in 1978 has given birth to the marked historical turning point and the symbolic beginning of China's reforms and opening up.[1] The open door policy includes not only policies that concern foreign investment, international trade, technology transfer, Special Economic Zones (SEZs) but also reforms such as accepting foreign aid and concessionary loans etc. The state encourages the involvement of foreign parties in China's economy by offering special concessions. The reforms in China has been characterized by shifts from planning to market mechanism, from ideological to material incentives, from centralized to a comparatively decentralized decision making and most importantly from an isolated self-reliant economy to an open economy.[2]

In opening up its economy to foreign investment, China's objectives were not merely to supplement domestic savings, but to bring in technology and management techniques. A significant step on China's opening up was taken on 8th July 1979 when a new law of the Republic of China on joint ventures using China and foreign investment established the basic legal framework for equity joint ventures.[3] It has provided that a joint ventures is encouraged to market its products out side China and the domestic sales was strictly regulated to the long term standing policy of protectionism. In the same year, a start was made by the opening up of the coastal regions of the Guandong and Fujian provinces for foreign direct investment subject to the joint venture laws of 1979. Foreign direct investment was allowed to enter with 100 per cent foreign ownership through equity joint ventures with state and local authorities or co-operative joint ventures where the Chinese contributions were mainly in kind. In addition to the series of measures, China was able to attract some foreign direct investment and successfully concluded some deals. Between 1979 and 1982, a total of 83 equity joint ventures with US $41 million worth of foreign direct investment were agreed between China and foreign investers.

The earlier cautious and strict open door policy has been modified in the early 1983 provisions in which the government have come up with a series of measures which includes concessions, such as the tax breaks, pricing, domestic sales, and more latitude for independent operations by foreign investors. The preferential policies for foreign investors have been regulated in September 1983, which is generally meant that joint ventures profitability would be enhanced through liberalization in the valuation of their capital contributions and the costs of domestically supplied inputs. In the case of joint ventures foreign investors were

authorized domestic sales, provided they will bring advanced technologies. They also provided the right to joint ventures to do business independently within the scope of Chinese laws, decrees and the agreement.

Since mid 1986, Chinese government has came up with a series of measures to encourage foreign investors. It was based on additional regulations to guide their implementation both at national and international levels. The numerous municipal and provincial regulations were also produced according to different local conditions, many of which offered even more preferential treatments than those issued by central government. The new regulations have provided the major incentives to foreign investors in the two types of joint ventures namely, joint ventures using advanced technologies, and / or producing for exports. Both types of joint ventures were eligible for special treatments from local governments. Their expenses such as land use, fees and certain subsidiaries to be paid to labour were reduced. They also received preferential tax treatments and other services in short supply. These guidelines have also provided major changes in the foreign exchanges rules and in the management of joint ventures etc. The promulgation of these regulations led to sudden rise of 41 per cent in pledged investment in joint ventures in 1987 over 1986 and a further increase of 59 per cent in 1988 over 1987. The growth of foreign direct investment in China remained strong in the first half of the 1989 (i.e. between January to June 1989), utilized foreign direct investment rise 21.5 per cent over the same period in 1988, pledged investment rose even more by 44.2 per cent. In addition there was an increase in the formulation of joint ventures from 3659 in 1989 to 4093 in 1990.

The opening up of the Chinese economy during the second half of the 1990 with attracting opportunities i.e. concessions and favourable environment has made this year as one of the most successful year for attracting foreign direct investment. Many joint ventures actually enjoyed recorded production and profit in that year, mainly due to the special concessions made by China. Despite, China had recovered successfully social and political stability, economic growth and foreign relations, the most of the difficulties remained unresolved. The strong reactions from foreign investors also encouraged the Chinese leadership to adopt liberal attitude towards foreign direct investment, which has marked the beginning of new phase of the open door policy.

Since late 1990, the government has came up with a series of measures, which includes the opening of the advanced economic centres of Pundong, New Developmental Zone in Shanghai among the four others. This has provided even more special than those other four SEZs during 1990. They have provided much broader areas for the possible foreign investment, including the establishment of foreign banks and their branches, joint stock banks with Chinese and foreign investment joint financial companies, real estate, business retailing and consulting services. They also provided most preferential treatments in terms of land use and tax relief, including an income tax and industrial commercial consolidated tax. In response to such policy measures foreign direct investment in 1990 totaled US $ 5.59 billion just below the 1985 US $5.93 billion. In early 1992, a series of measures were undertaken to attract high quality of foreign direct investment in China. Typical examples includes the opening up of new foreign investment opportunities in sectors where foreign direct investment was strictly restricted in the 1980s, such as the tertiary sectors, road and

telecommunications and primary industries such as the exploitation and development of coal, oil and other minerals. Many other measures were also undertaken, so as to boost the growth of foreign direct investment in China. These measures have enabled China to attract over 47, 000 new joint ventures, co-operative enterprises and wholly owned foreign ventures in 1992. More than US $30 billion of foreign direct investment contracts were signed, which accounted for about one quarter of the total fund invested in the developing countries. Since 1993, China has taken a series of important steps towards liberalizing its economy by loosening its restrictions on investment in real estate.[4] The year 1993 was even more successful and 83265 new foreign investment projects were approved with a total pledged and utilized foreign direct investment of US $110.85 billion and US $25.75 billion. By the end of 1993, the total number of foreign invested enterprises in China reached 167500, with a total of pledged foreign direct investment of US $216.91 billion and actual foreign direct investment of US $56.48 billion.

Further, the new environment for foreign direct investment has been brought on July 1994, by the promulgation of new companies laws. One such aim was to create a platform for reforming the state owned enterprises economy and also to provide a means to integrate the foreign investment environment. The second, important gesture was the China's decision to impose restrictions on foreign direct investment in car industry until 1997, with the provision that any foreign investers to assemble cars had to starts with 60 per cent local contents. In particular, one policy stated that foreign car companies willing to build up co-operative or foreign funded car companies in China using its own product, patent and trade marks must have developmental capacity and advanced manufacturing technology, an international marketing channel

and satisfactory financial ability.[5] By 1995, Chinese government has came up with the promulgation of new regulations to guide the direction of future investments. In late 1995, China overhauled prevailing preferential tax policies of foreign funded joint ventures of 15 per cent corporate tax in SEZs, 24 per cent in 'open areas' and 30 per cent else where compared with 55 per cent tax for state owned enterprises with a flat 30 per cent national corporate tax reform measures have been accompanied by other measures, including tariff cuts, limited convertibility of the Chinese currency, the elimination of the many import quotas and controlling and easing out of restrictions on operations by the joint ventures with foreign investment.[6]

By the end of 1995, the total number of foreign invested enterprises in China had further increased to 258903 with a total number of foreign investment of US $133.37 billion (which is more than double by the end of 1993), making China the second largest destination for foreign investment in the entire world after USA. The average size of the foreign investment in new projects increased to US $1.77 billion in 1994 and US $2.45 in 1995 with many world leading countries floating into China.

In June 1995, the interim regulations on foreign direct investments and the industrial catalogue guiding foreign investment were formulated and promulgated. For the first time, industrial policies aiming at inviting foreign direct investment were published in the form of laws and regulations, which promote transparency of policies.

The Ninth Five year plan (1996 – 2000), also directed to encourage foreign direct investment in the Western part of China, in the infrastructural development and in the loss making state owned enterprises.[7] The increasing foreign direct investment in China has been

regulated by macroeconomic policy and China particularly encourage foreign direct investment that will contribute to the long term development of the national economy. The central focus of the China's open door policy in the aspect of foreign direct investment is increasingly put on quality although, quantity remains very important. In September 1996, with the approval of the interim procedures on establishing pilot Sino foreign joint ventures, wholesale business, which is a major step towards expanding the opening up in the service sector. In late 1997, the Chinese government revised the above mentioned catalogue in line with the development of the national economy. The revised catalogue reflects expansion in the investment scope encouraged by the state and highlights priority industries. It embodies the principles of compliance with structural readjustment of being conducive to the introduction of advanced technology and encouragement of foreign investment in China's Central and Western areas.[8]

The items in the catalogue encouraged for foreign direct investment mainly included, new agricultural technology, comprehensive development of agriculture, energy resources, communications, important raw materials, new and high technologies, export oriented and foreign currency earning projects, comprehensive utilization of resources, prevention of environmental pollution and those that give due advantages to China's mid-west areas. Meanwhile, foreign investment is directed towards the technological upgradation of traditional industries and industrial bases and to continue development of labour intensive projects that comply with the states industrial policies. In late 1998, the interim procedures on joint ventures travel agent was promulgated, which engaged the geographical areas for permitted joint owned travel agents to the regions outside the tourism development zones.

In recent years, in addition to the fields of commerce and foreign trade, China has started opening up in other areas such as finance, insurance, transportation, international freight, forwarding legal service, tourism, advertising, medical care and public health, accounting assets appraisal, education learning, engineering, design consulting and real estate. The opening pattern of trade in services has been transferred one, involving limited sectors to a pattern emphasizing many more industries and sectors. The SEZs, and 'open cities' are authorized to approve projects valued less than US $10 million and beyond that will be approved by the state council, in addition to that of MOFTEC. The lower limit for making investment projects for foreigners is 25 per cent. The emphasis is placed to attract more foreign capital to inland provinces, high technology and infrastructural projects and in priority sectors. The numerous facilities such as the availability of free ports, bonded zones, and locally "Organised Development Zones" are provided to foreign investors. The new service sectors including retailing, insurance and tourism have been gradually opened to foreign firms. The foreign investment enterprises are provided easy access to foreign exchange, even for profit repatriation operations. China is now practicing dual-track enterprises income tax policies for domestic and foreign funded companies. The virtual burden of income taxes for domestic enterprises stands at 22 per cent while that for foreign funded firms was 12 per cent.

Further in 2000, China revised the law of the People's Republic of China on Chinese foreign contractual joint ventures and the law of the People's Republic of China on wholly foreign owned enterprise and discarded certain restrictions regarding the balance of foreign exchange account and localization of supplies. In 2001, the law of the People's Republic of China on Chinese foreign equity joint ventures was also

revised.[9] This allows the purchase of raw materials and fuel by equity joint venture according to the principle of fairness and justice in the domestic or international market.[10] In order to guarantee the legitimate rights and interests of foreign invested enterprise and their employees, the Chinese government has formulated the regulation of the labour management in foreign invested enterprise, making stipulations concerning employee recruitment, training, vacation, leave and salaries etc.[11]

1.2 Trends in FDI Flows

After following the open door policy measures in 1979, foreign direct investment flows has been considerably increased in China and in the year 2001, China's attraction of foreign direct investment continued to stay at a relatively higher level. The amount of foreign direct investment has been increased from US $3709 million in 1987 to US $6596.1 million in the year 1990.

Table 3.1
Foreign Direct Investment in China: Approval vs Actuals During 1990- 2001

(US $Million)

Years	Approvals	Actuals	% Growth (Actuals)
1990	6596.1	3487.1	2.79
1991	11976.8	4366.3	25.21
1992	58123.5	11007.5	152.10
1993	11435.7	27515.0	150.00
1994	82679.8	33766.5	22.72
1995	91281.5	37520.5	11.12
1996	73276.0	41726.0	11.21
1997	51004.0	45257.0	8.46
1998	52102.0	45463.0	0.46
1999	41223.0	40319.0	-11.31
2000	62380.0	40715.0	0.98
2001	69194.6	46846.0	15.06

Source: World Investment Directory and China Investment Report (Various issues)

Following the open door policy and subsequent measures, the amount of foreign direct investment as presented in Table 3.1, has increased from US $11976.8 million in 1991 to US $69194.6 million in the year 2001. After getting the highest percentage rate of growth in the year 1992, the percentage annual rate of growth of foreign direct investment has decreased and even it became negative in the year 1999. But again foreign direct investment environment has improved and China has realized a 15 per cent rate of growth in the year 2001. Moreover, foreign direct investment has increased 10 times in the year 2001 as compared to the year 1990.

Country-Wise Break-Up of FDI Flows

The country-wise break-up of foreign direct investment presented in Table 3.2(a), shows almost the similar pattern over the years. The important feature is that except the few leading countries like Hong-Kong, Taiwan and Germany almost all the investing countries have shown a positive attitude in making investment outlets in China. During the period 1990- 2001, though there was a sharp decline in foreign direct investment from Hong-Kong and Taiwan but they continue to be the major source of foreign direct investment. In the year 1987, the top five investors in China were Hong-Kong, USA, Japan, Spain and Germany and together they account for 79 per cent of the total foreign direct investment flows whereas in year 2001, the top five investors were Hong-Kong, USA, Taiwan, Japan and South Korea and together they account for the 64 per cent of the total foreign direct investment flows.

The flows of foreign direct investment from the Hong-Kong was US $3833 million that is 58.1 per cent of the total foreign direct investment flows in 1990 which has reached to a peak of US $3939 million in 1993 and to only US $2068.9 million that is 30 per cent of the

Table 3.2 (a)
Country-Wise Break-Up of Foreign Direct Investment in China During 1990-2001

(US $ Million)

Countries / Years	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
Hong Kong	3833 0	7215 0	40044 0	73939 0	46971 0	40996 0	28002 0	18222 0	17613 3	13328 9	16961 1	20685 9	327811 2
USA	358 0	548 0	3121 0	6813 0	6010 0	7471 0	6916 0	4937 0	6483 7	6016 1	8000 9	7514 9	64189 6
Taiwan	890 0	1389 0	5543 0	9965 0	5395 0	5849 0	5141 0	2814 0	2981 7	3374 4	4041 9	6914 2	54298 2
Japan	457 0	812 0	2173 0	2960 0	4440 0	7592 0	5131 0	3401 0	2749 0	2591 3	3680 5	5419 7	41406 5
Republic of Korea	46 0	137 0	417 0	1557 0	1806 0	2998 0	4236 0	2181 0	1640 9	1483 6	2385 8	3487 4	22375 7
Singapore	103 0	155 0	997 0	2954 0	3778 0	8666 0	6314 0	4469 0	3001 5	2258 2	2030 7	1984 2	36710 6
United Kingdom	119 0	132 0	287 0	1988 0	2748 0	3577 0	2542 0	1446 0	1681 6	1085 4	834 2	1515 6	17955 8
Canada	15 0	31 0	316 0	1184 0	890 0	982 0	823 0	907 0	946 8	699 2	868 4	1295 5	8957 9
Germany	46 0	558 0	130 0	249 0	1233 0	1660 0	998 0	613 0	2374 7	938 7	2900 1	1171 5	12872
Australia	17 0	44 0	276 0	638 0	849 0	1257 0	522 0	614 0	690 0	588 4	696 7	675 0	6867 1
Others	712 1	95 0	4819 5	918 0	8559 8	10233 5	12651 0	11400 0	11938 8	8858 8	19979 0	18530 7	117826 9
Total	**6596.1**	**11116**	**58123.5**	**103165**	**82679.8**	**91281.5**	**73276**	**51004**	**52102**	**41223**	**62379.3**	**69194.6**	**711271.5**

Source World Investment Directory and China Investment Report (Various issues)

Notes Data on FDI are on Approval basis and includes only in Secondary Sector and has been transferred from the exchange rates taken from the International Financial Statistics (Year book), IMF, 2003

total foreign direct flows in the year 2001. This has been followed by USA whose share has been increased from US $358 million that is 5.4 per cent of the total foreign direct investment flows in 1990 to a sum of US $7514.9 million that is 10.9 per cent of the total foreign direct investment flows in the year 2001. This has been followed by Taiwan with its share at 10 per cent, Japan with 7.5 per cent out of the total foreign direct investment flows in the year 2001.

Country-Wise Break-Up of FDI with Selected Statistical Values

We have analysed the data on country-wise break-up of foreign direct investment in China, which shows that although there is almost similar pattern but there is a wide variation among the different countries.

The country-wise break-up of foreign direct investment together with the compound rate of growth and other statistical values can be had from the Table 3.2(b) during the period 1990-2001. The table asserts that the compound rate of growth of foreign direct investment during the period 1990 – 2001 was 12. 16 per cent. The top five countries which was having the highest compound rate of growth were South Korea with 38.85 per cent, Canada with 33.84 per cent, Germany with 29.06 per cent, Australia with 27.37 per cent and Singapore with 24.07 per cent per annum during the above mentioned period.

The top five countries in terms of foreign direct investment flows were Hong-Kong, USA, Taiwan, Japan and Republic of Korea and together they account for the 71.7 per cent of the foreign direct investment flows Table 3.2(a) had a coefficient of variation (at 73.12 per cent, 49.17 per cent, 55.41 per cent, 69.73 per cent respectively) during the period 1990 – 2001. But the average combined rate of growth for the above top five countries is merely 16.7 per cent during the period 1990 – 2001. The highest coefficient of variation among the top ten countries has

Table 3.2(b)

Country - Wise Break - Up of Foreign Direct Investment in China With Selected Statistical Values During 1990-2001

Country	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per yr.
Hong Kong	3833.00	73939.00	27317.60	19974.54	73.12	Ln (HK)	9.75854 (18.43136)	.02846 (0.39571)	.015	2.89
USA	358.00	8000.90	5349.13	2630.04	49.17	Ln (USA)	6.89167 (14.79188)	.21431 (3.38543)	.534	23.90
Taiwan	890.00	9965.00	4524.85	2507.11	55.41	Ln (T)	7.77231 (19.08813)	.07194 (1.30036)	.145	7.46
Japan	457.00	7592.00	3450.54	1998.04	57.91	Ln (J)	7.00478 (17.67011)	.14152 (2.62756)	.408	15.20
Republic of Korea	46.00	4236.00	1864.64	1300.14	69.73	Ln (RK)	5.13115 (8.77182)	.29155 (3.66827)	.574	33.85
Singapore	103.00	8666.00	3059.22	2501.45	81.77	Ln (Sing)	6.09570 (8.40140)	.21568 (2.18780)	.324	24.07
United Kingdom	119.00	3577.00	1496.32	1091.14	72.92	Ln (UK)	5.72918 (9.18097)	.17758 (2.09441)	.305	19.43
Canada	15.00	1295.50	746.49	414.52	55.53	Ln (Can)	4.23167 (6.31309)	.29146 (3.20029)	.506	33.84
Germany	46.00	2900.10	1072.67	880.91	82.12	Ln (Ger)	4.84608 (9.33945)	.25508 (3.61805)	.567	29.06
Australia	17.00	1257.00	572.26	339.70	59.36	Ln (Aust)	4.36316 (7.10557)	.24194 (2.89986)	.457	27.37
Total (Inclusive Others)	6596.10	111435.70	59272.63	30235.93	51.01	Ln (TT)	10.02345 (21.29209)	.11479 (1.79476)	.244	12.16

Note : Figures in Parenthesis show t- values.

been found to be with Germany, having the highest variation that is 82.1 per cent where as the lowest coefficient of variation is found with USA that is 49.2 per cent meaning thereby that it has a strong stability in FDI flows.

Sector-Wise Break-Up of FDI Flows

The sector-wise break-up of foreign direct investment Table 3.3(a) asserts that the foreign direct investment flows has shown almost a similar pattern. The top five sectors which has attracted the bulk of foreign direct investment flows includes manufacturing industry, real estate, agriculture, forestry and fishing, mining and quarrying, petroleum and wholesale trade and together they account for the 96 per cent of the total foreign direct investment flows in the year 1987, whereas in the year 2001, the top five sectors were manufacturing industry, real estate, social services, production and supply of gas and construction and together they account for the 90 per cent of the foreign direct investment flows. Among the three main sectors namely primary, secondary and tertiary, the manufacturing industry has been able to attract largest share of foreign direct investment that is their share has been increased from 8.4 per cent in 1990 to 70.6 per cent in 2001. The other sectors which has attracted the considerable portion of the foreign direct investment is the real estate (public utilities) whose share has been increased from US $452.5 million that is 6.9 per cent in the year 1990 to US $5030.6 million that is 7.3 per cent in the year 2001. This has been followed by construction whose share has been decreased from US $181.1 million that is 2.8 per cent in 1990 to US $1822.8 million that is 2.6 per cent in the year 2001. Likewise, the agriculture and allied sectors share has been increased from US $122.3 million that is 1.9 per cent in 1990 to US $1761.7 million that is 2.5 per cent in the year 2001. Similarly, the above sectors has been

Table 3.3(a)
Sector - Wise Break - Up of Foreign Direct Investment in China During 1990-2001

(US $Million)

Sectors / Years	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
Manufacturing Industry	5569 2	9622 7	32666 7	51173 7	43898 9	61647 6	50486 0	27065 0	30827 2	25331 8	44254 3	48846 9	431390 0
Real Estate (Public Utilities)	452 5	1503 7	18079 6	43771 2	23861 5	17835 4	12851 0	8891 0	6647 5	4177 9	5232 1	5030 6	148334 0
Construction	181 1	134 2	1838 6	3878 4	2393 5	1918 4	2001 0	3120 0	175 0	1096 2	830 9	1822 8	20965 1
Agriculture, relating Forestry and Fishing	122 3	220 0	678 1	1191 5	972 5	1735 8	1139 0	1065 0	1204 2	1471 7	1483 1	1761 7	13044 9
Wholesale trade, Retail trade and Food Services	106 6	174 2	1443 8	4606 5	3921 9	3426 7	2347 0	1839 0	131 5	1204 1	1435 1	1398 1	2326 5
Transportation, Storage Postal and Telecommunication Services	36 5	95 0	1543 4	1489 9	2030 0	1697 0	1599 0	2622 0	2301 2	1114 0	1440 4	883 5	16851 9
Scientific Research and technical Services	32 0	18 6	61 9	587 8	273 6	277 8	175 0	138 0	0 0	133 7	250 3	654 3	2603 0
Mining and Quarrying	0 4	0 0	2 7	80 5	53 7	11 6	13 0	739 0	852 2	322 2	506 4	644 5	3226 1
Health and Social Services	38 0	64 0	395 3	477 5	1979 0	837 4	354 0	143 0	141 7	67 3	154 3	133 1	4784 6
Education, Culture Art and Video Cast	5 1	56 0	96 8	451 7	608 4	345 0	171 0	70 0	22 2	72 2	83 3	71 7	2053 8
Others	52 4	87 6	1316 6	3727 0	2686 8	1548 8	2140 0	5312 0	7042 3	6231 5	6709 1	7947 4	44801 5
Total	6596 1	11976 0	58123 5	111435 7	82679 8	91282 5	73276 0	51004 0	52102 0	41223 0	62379 3	69194 6	712717

Source · World Investment Directory and China Investment Report (Various issues)

Note Data on FDI are on Approval basis and has been transferred from the exchange rates taken from the International Financial Statistics (Year Book), IMF, 2003

followed by wholesale trade, retail trade and food services with US $1398 that is 2 per cent, transportation storage, postage and telecommunications services with US $883.5 million that is 1.3 per cent, scientific research and technology services with US $654.3 million that is 1 per cent out of the total foreign direct investment flows in the year 2001.

Sector-Wise Break-Up of FDI With Selected Statistical Values

We have analysed the data of sector-wise break-up of foreign direct investment in China during the period 1990 – 2001, which asserts that, there is a large variation among the different sectors.

The sector-wise break-up of foreign direct investment together with the compound rate of growth and other statistical values can be obtained from the Table 3.3(b), during the period 1990 – 2001.

The Table 3.3(b), depicts that the compound rate of growth of foreign direct investment during the period 1990 – 2001 was 12.16 per cent per annum. It can be further stated that the compound rate of growth of foreign direct investment among the top five sectors includes mining and quarrying with 88.64 per cent, transportation industry with 23.39 per cent, scientific research and technical service with 21.32 per cent, agriculture with 19.87 per cent, construction with 13.04 per cent during the period 1990 – 2001.

The top five sectors which have attracted the bulk of foreign direct investment were namely manufacturing industry, real estate, construction, agriculture and wholesale trade and together they account for the 89.6 per cent of the foreign direct Investment flows Table 3.3(a) had a coefficient of variation (at 47.79 per cent, 99.31 per cent, 62.87 per cent, 48.61 per cent and 72.48 per cent respectively) during the period 1990 – 2001. But the average combined rate of growth for the above five sectors is merely 12.8 per cent during the aforesaid period. The highest variation among

Table 3.3 (b)
Sector-Wise Break-Up of Foreign Direct Investment in China With Selected Statistical Values During 1990-2001

Sectors	Minimum	Maximum	Mean	Standard Deviation	Coefficiet of Variation	Dependent Variation	Intercept	Regression Coefficient	R-Squared	CRG (%) Per year
Manufacturing Industry	5569 20	61647 60	35949 12	1718 15	47 79	Ln (MI)	9 59380 (24 54738)	11067 (2 08417)	303	11 70
Real Estate (Public Utilities)	452 50	43771 20	12361 12	12275 89	99 31	Ln (RU)	8 54550 (10 64721)	05156 (0 47284)	022	5 29
Construction	134 20	3878 40	1747 09	1098 34	62 87	Ln (Con)	6 33370 (10 24069)	12254 (1 45820)	175	13 04
Agriculture, relating Forestry and Fishing	122 30	1761 70	1087 08	528 42	48 61	Ln (AF)	5 59783 (16 69494)	18127 (3 97905)	613	19 87
Wholesale trade, Retail Trade and Food Services	106 60	4606 50	1934	1402 34	72 48	Ln (WH)	6 32499 (9 32349)	12970 (1 40714)	165	13 85
Transportation, Storage Postal and Telecommunication Services	36 50	2622 00	1404 33	784 56	55 87	Ln (TS)	5 45978 (7 71156)	21021 (2 18521)	323	23 39
Scientific Research and Technical Services	0 00	654 30	216 92	212 43	97 93	Ln (SR)	3 79884 (6 74201)	19327 (2 46701)	403	21 32
Mining and Quarrying	0 00	852 20	268 85	328 95	122 36	Ln (MB)	26784 (27552)	63467 (5 00329)	734	88 64
Health and Social Services	38 00	1979 00	398 72	548 69	137 61	Ln (HS)	5 47424 (7 39305)	01923 (19122)	004	1 94
Education, Culture Art and Video Cast	5 10	608 40	171 5	192 17	112 28	Ln (EL)	4 31489 (5 09351)	02930 (02546)	006	2 97
Total (Inclusive Others)	6596 10	111435 70	59272 63	30235 93	51 01	Ln (TT)	10 02345 (21 29209)	11479 (1 79476)	244	12 16

Note Figures in Parenthesis show t – values

the top ten sectors has been found to be with mining and quarrying having 122.4 per cent whereas the lowest variation among the top ten investing sectors has been found to be with agriculture forestry and fishing with 48.6 per cent meaning thereby that it has strong stability in foreign direct investment flows.

3.2. FOREIGN DIRECT INVESTMENT IN INDONESIA

3.2.1 Government Policy

The Indonesian economy is predominantly an agricultural economy employing almost 50 per cent of the working population. Agriculture forestry and fishing together provide a quarter shares of the countries GDP. Indonesia, principal mineral source is petroleum along with substantial reserves of coal, gas, bauxite, tin, nickel, silver and gold etc.

Foreign direct investment has played a major role in Indonesia's industrilisation programme. Since the inception of liberal policy framework in 1967, Indonesia has undergone the usual stages of industrialization moving from import substitutions in intermediate and capital goods and more recently to export oriented expansion. Since oil is very important in the Indonesian economy, changes in oil prices have played a key role in stimulating these structural changes. Before, the advent of the new regulations on foreign investment in 1967, Indonesia was suffering from high rates of inflation, low levels of trade, low foreign exchange reserves, underutilization of existing capacity and a badly damaged economic and physical infrastructure.

In 1967, the government came extensively with the series of measures, which liberalized the economy. This includes liberal trade and industrial policies, provision of basic goods, promotion of import substitution in consumption goods, encouragement of private investment

in priority sectors by offering tax holidays, exemptions on import duties and sales tax for imports of machinery and equipments, accelerated depreciation, guaranteed repatriation of capital and profits and provision for carrying and forwarding losses. Although, the foreign firms are not allowed to enter the domestic market but there were no restrictions on foreign equity and employment of expatriates and 100 per cent foreign ownership was allowed.

The amendment of the Act of 1967 in 1970, provides the series of measures which includes (a) legal entity status to the foreign investment enterprises which is organized under the Indonesian law and has its domicile in Indonesia (b) the owner of the enterprise has full authority to appoint the management of the enterprise in which his capital is invested (c) a foreign investment enterprise is required to meet its need for manpower with Indonesian citizens (d) a foreign investment enterprises is allowed to bring in and employ foreign managerial and expert personnel in positions that cannot yet be filled by Indonesian citizens (e) a foreign investment enterprises is required to conduct and provide regular and systematic training and educational facilities in Indonesia and / or abroad for Indonesian citizens with the aim of gradually replacing foreign employees with Indonesian citizens (f) the permit for foreign investment enterprises specifies the duration of its validity, a duration that must not exceed 30 years (g) a foreign investment enterprises is granted the right to transfer the company profits, proceeds, principal loans, interest, royalties fees and license fees, expenses of expatriate employees etc in the original currency of the invested capital at the prevailing exchange rate at the time of transfer.[12]

Moreover, the increase in oil prices shifted government policy towards diversification of the economy and foreign investment

regulations has been made more restrictive which includes (1) Indonesian equity share has to be increased to 51 per cent within a ten years period; (2) the list of closed sectors was extended; (3) tax incentives were reduced and (4) the restrictions on employment of expatriates was increased.

There were some improvements in administrative procedures including the publication of the investment priority list and the establishment of "one step" service center at the board of investment. The increased restrictiveness was highly related to the violent anti Japanese riots that accompanies the visit of P.M Tanaka in 1974.[13] In 1974 as a consequence of Malay-riots, which were a protest against the over presence of Japanese foreign investment projects in Indonesia, the regulations on foreign investment became more restrictive. Investors were only allowed to invest in the form of a joint venture with a local partner. The decline in foreign direct investment in the late 1970's is related to the increasingly restrictive policies that are imposed in the oil boom period and the end of the easy phase of import substitution in final consumer goods.

Since 1982, declining oil prices have reduced export and government revenues and appreciation of the currency especially since 1985 has increased debt service payments markedly. This has resulted in major changes in economic structure in Indonesia. In May 1986, the so-called "Package of May 1986" was introduced i.e. deregulations with main aim to improve the climate for foreign investors and to improve the competitive positions of the non-oil sector. The devaluation of the currency first in 1983 and then again in September 1986, followed by a large increase in non-oil exports as inflation was controlled and the trade, industrial, transportation and financial sectors were markedly deregulated

following the devaluation, many non-tariff import barriers were replaced by tariffs and several investment barriers, such as complicated licensing requirements were reduced or removed. These and other related reform measures have greatly increased competitive pressure in Indonesian manufacturing. On the foreign direct investment side, one-stop service was extended to the regional boards of investment in 1984 and investment licensing procedures were simplified in 1985. The tariff reforms and drastic overhaul of the customer system were undertaken in 1985 and an improved duty drawback scheme for foreign investors was announced in May 1986. Further, deregulation came in December 1987, when joint ventures were allowed to export their own products as well as products of other companies. In addition, the export production ratio that was required for export-oriented investors was reduced from 85 per cent to 65 per cent. In October 1988, the entry of the more foreign banks in the form of joint ventures with a maximum foreign ownership share of 85 per cent was allowed. In November 1988, foreign investors were allowed to engage in domestic distribution of their products through joint ventures. In May 1989, relatively simple list of sectors closed to foreign investment replaced the previous priority list, which had become quite complex and restrictive.[14]

In 1985 and 1986, investment approvals were declined again as a result of recession in Indonesia as well as in the world economy. These were transition years in which elements of the restructuring strategy were in place, but there was still a lack of clear direction. Furthermore, there was speculation that devaluation would be inevitable given the rapid decline in oil prices. Investment approvals, both domestic and foreign picked up considerably after the devaluation in September 1986 when the

government gave strong indications that act was serious about restructuring and reform especially the promotion of exports.[15]

In June 1994, the government further came up with more liberal and relaxed foreign direct Investment regulations, which make foreign direct investment more attractive. In the same year government issued an important deregulatory package of foreign direct investment, which allows foreign parties to own 100 per cent of the issued capital of the newly established Indonesian companies.

The 1983, income tax Act has been amended in 1994, which simplified and lowered tax rates substantially. Further, the 1994, government regulations provides that (a) foreign direct investment company may be established as a joint venture between a foreign company and Indonesian partner. A foreign company and an Indonesian partner may be represented by a legal entity. There were no requirements on the minimum amount of investment (equity plus loan). The amount were left to the parties concerned to determine, based on the economies of scale and other business considerations (b) a foreign investment company in infrastructure projects such as port, power generation, the transmission and distribution of electricity for public use, telecommunications, shipping, airlines, and supply of portable water, public railways and nuclear power generations should be established by way of joint ventures between foreign companies and Indonesian partner. The share of Indonesian partner should be at least 5 per cent of the total issued capital at the outset of Joint venture company (c) a foreign investment company may be established as a straight investment meaning there by that foreign citizen and / or entities own fully 100 per cent of the shares with some conditions (d) a foreign investment company which has already commenced commercial operation, may apply to export its

existing production capacity to produce additional products either similar to or different from its current products by investing additional capital in new production facilities (e) a foreign direct investment company that has already commenced commercial operation may purchase the shares of an existing domestic company through direct placement and / or the domestic capital market, provided that the field of investment is open to foreign investment (f) the foreign manufacturing companies investing in Indonesia are now allowed to (i) sell their own products in domestic market up to the level of wholesaler which was previously allowed only for joint venture company (ii) export goods produced by other companies (iii) act as a general importer (iv) establish a retail business company to sell their products as well as other companies products to the end consumers.[16]

Since May 1994, the requirements for minimum equity in most foreign investments have been eliminated. In sectors, which require some Indonesian equity, joint ventures must include a 5 per cent minimum local participation. Foreign operational facilities which take the form of limited liability companies are authorized to purchase shares or to acquire an existing local firms.[17] The 1997, financial crises brought certain measures which includes the elimination of foreign shareholding limit of 49 per cent in firms other than financial firms and are permitted 100 per cent foreign ownership of manufacturing affiliates as well as the wholesaling of their products.[18] Indonesia, has managed a dispute settlement mechanism and also amended its patent, copyrights and trademark laws in 1997 in compliance with TRIPs agreement. The presidential decree No. 99 of 1998 provided encouragement to foreign investors by opening the medium and large scale sectors.

There is no limitation on the foreign direct investment company's access to sources of investment funding. The government regulations of 1996 and 1999 stipulates that for new companies in certain industries that are categorized as pioneers, their companies income tax could be borne by the government for a maximum period of 10 years if located in Java and Bali islands and of 12 years if located outside Java and Bali islands. These periods are accumulation of (i) a three year of basic facility for pioneer industries in Java and Bali islands and five years if outside Java and Bali islands (ii) a year of additional facility subject to the following criteria (a) employing at least 200 workers (b) at least 20 per cent of its shares is owned by a cooperative since the start of commercial production (c) minimum investment of US $200 millions including land and building (iii) the new projects should be realized within a maximum period of five years since the approved date. If the project could be realized within less than five years the remaining years can be accumulated to the basic and additional facility.[19]

In normal cases VAT at the rate of 10 per cent is applied to imports manufactured goods and to most of the services. In addition, there is also sales tax on luxury goods ranging from 10 per cent to 35 per cent whenever applicable. The payment of dividends, interest, royalties, technical and managerial fees and the services performed in Indonesia for Indonesian residents are subject to withholding tax. The payments to Indonesian residents are subject to 15 per cent tax except for technical and management services in which case the rate is 9 per cent whereas payments to non-residents are subject to 20 per cent tax.[20] For the investment activities in the certain priority sectors and / or certain areas could have incentives of (a) loss carried forward within 8 years (b) depreciation rate for the depreciation assets. The investment activities

located in the eastern part of Indonesia are granted special incentive i.e. 50 per cent reduction of land and building tax for 8 years. The special incentives for the investment activities located in bonded zones includes among others (a) exemption from import duty, income tax of article 22, value added tax and sales tax on luxury goods and importation of capital goods and equipment including raw materials for the production process (b) allowed divesting their products amounting to 50 per cent of the finished products and 100 per cent of the unfinished products exported (in terms of realization of export value) to the Indonesian customs area, through normal import procedure including payments of customs duties (c) allowed setting scrap or waste to Indonesian customs area as long as it contains at the highest tolerance of 5 per cent of the amount of the material used in the production process (d) transition of goods from a producer located outside bonded zones for further processing is entitled the same fiscal facilities as exported goods.

The government has established 15 integrated Economic Development Areas KAPET, throughout Indonesia. For investment activities in these areas shall enjoy incentives among others (a) article 22 income tax exempt on the income for the importation of capital goods, raw materials and other equipments that are directly used in production activities (b) loss compensation as from the subsequent fiscal years consecutively up to 10 years (c) article 26 income tax deductions on dividends on the amount of 50 per cent from the amount otherwise payable (d) no VAT and sales tax on luxury goods imported for entrepreneurs in KAPET for domestic purchases and / or imports of capital goods and other equipments, import of taxable goods for further processing.

The law No.5 of 1999 deals with the prohibition of monopolistic Practices and unfair business competition. This new law reflects strong commitments from the government to create a fair and healthy business competition and a more conducive climate for investment and business activities in Indonesia. The government recently introduced new tax holidays regime. Tax holidays will be granted in respect of approved projects in certain industry sector including textiles, selected chemicals and pharmaceuticals, iron and steel and crude oil refining. The tax holidays are granted for (a) the projects approved by the investment coordinating board and (b) projects approved by the Ministry of Finance based on the recommendations of the committee assigned with the responsibility of reviewing applications for tax holidays.[21]

The bonded zones and industrial estates have been set up to encourage the processing of exports. The goods may be brought into bonded zones free of import duty for exports elsewhere. The goods brought into an industrial estate are also subject to favourable regimes with respect to VAT and sales tax on luxury goods. The corporate income tax is subject to 10 per cent on the first 25 million Indonesian rupiahs of taxable income, 15 per cent on the next 25 million rupiahs (i.e. the bond from 25 million rupiahs to 50 million rupiahs) and 30 per cent on the bond of taxable income in excess of 50 million rupiahs.[22] The non-resident companies having their permanent establishment in Indonesia are liable for an additional 20 per cent tax on the profits, after deducting corporate income tax. If the non-resident company is resident in any treaty country, the rate of the additional 20 per cent resident tax is reduced by the relevant treaty. The rate of withholding tax on dividends, interest and royalties is 20 per cent.

In principle, all lines of business are open to foreign investment except for those business activities or lines of business that have a vital role in the Indonesian defence and security and other business entities, which are closed to foreign investment by the presidential decree 2000, which includes among others (i) germs and plasma cultivation (ii) natural forest exploitation (iii) lumber contractors (iv) taxi/bus transportation services (v) small scale shipping (vi) trading and trade supporting services except large scale retailers (walls, supermarkets, developmental stores, shopping centers) wholesale trading (distributors / wholesalers, exporters and importers, exhibitors quality certification service providers, warehousing service providers other than line and ports and after sales services (vii) radio and television broad casting and (viii) cinema operation.

A foreign direct investment company in Indonesia (known locally as Penanaman Model Asing or PMA) can take the form of 100 per cent foreign owned limited liability company through a joint venture with Indonesian partners. In the case of joint ventures, the Indonesian joint ventures are required to own at least 5 per cent of shares. The corporate law requires that there must be at least two shareholders in a PMA company or any limited liability company. The shareholders can be two individuals, two companies or a mixture of both. Therefore, in the case of a PMA company with full foreign ownership, the foreign investors initially planning the investment in Indonesia have to invite another foreign party to participate in shareholding of the proposed company. For a PMA company to start its commercial operations it has to take a permanent business license which will be valid for 30 years.

Foreign investers may own a maximum of 95 per cent of the shares of PMA companies involved in construction and operation of parts and

harbours, processing and provision of clean water for the public, electricity production, transportation and distributions, generation of atomic power, public railways service, shipping and medical services (covering among other building and operations of hospitals, medical, checkups, clinical laboratories and mental rehabilitation service). In the case of telecommunications and regular / non-regular chartered commercial airlines foreign investors are permitted to form a joint venture with an Indonesian company. Previously, the foreign ownership in these industries was limited to a maximum of 40 per cent. However, based in presidential decree No. 118/2000 dated August 16, 2000 there is no limitation on the percentage.

3.2.2 Trends in FDI Flows

The persistent economic predicaments compelled the government to come extensively with the foreign investment laws in 1967, which liberalized the economy. As a result of such measures foreign direct investment flows has increased from US $210.6 million in 1967 to US $1153.9 million in 1975. But after having ups and downward trends it raised to US $1121 million in 1984. In the year 1990, the total foreign direct investment has increased by around 46 per cent as compared to the 1967. After the year 1990, foreign direct investment flows has increased tremendously (Table 3.4) from US $10466.1 million in 1992 to US $33,816.1 million in the year 1997.

After having increasing and decreasing trends it has become 1.2 times with US $15043.4 million in the year 2001. A significant aspect of the foreign direct investment flows in Indonesia is that there is a large differen: between approvals and actuals. .:though, the gap between the two has came down from 9 times in 1997 to 5 times in the year 2001.

Table 3.4
Foreign Direct Investment in Indonesia: Approvals Vs Actuals During 1990-2001

(US $ Million)

Years	Approvals	Actuals	% Growth (Actuals)
1990	9639.6	1093.0	
1991	9030.2	1482.0	35.6
1992	10466.1	1777.0	19.9
1993	8153.8	2004.0	12.8
1994	27046.4	2109.0	5.2
1995	39891.6	4346.0	106.1
1996	29941.0	6194.0	42.5
1997	33816.1	4677.0	-24.5
1998	13585.5	-356.0	-92.4
1999	10892.2	-2745.0	671.1
2000	15420.0	-4500.0	63.9
2001	15043.4	-3277	-27.2

Source : World Investment Directory and World Investment Report (Various Issues)

Country-Wise Break-Up of FDI Flows

The country-wise break-up of foreign direct investment presented in Table 3.5(a), depicts the fluctuating trend over the years. It asserts that all the leading investors' countries share has been decreased in the year 2001 as compared to 1990. In the year 1989, the top five investors in Indonesia were Japan, Republic of Korea, Hong-Kong (China), USA and Netherlands and together they account for the 48 per cent of the total foreign direct investment flows whereas in the year 2001, the top five investors were Malaysia, Saudi Arabia, Singapore, Japan, UK and together they account for around 42 per cent of the total foreign direct investment flows.

The flows of foreign direct investment from USA has been increased from US $153.7 million that is 1.8 per cent of the total foreign direct investment flows in 1990 to a peak of US $2770.6 million that is 6.9 per cent of the total foreign direct investment flows in 1995 and to US

Table 3.5 (a)
Country - Wise Break - Up of Foreign Direct Investment in Indonesia During 1990-2001

(US $Million)

Country/ Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
USA	153.7	275.6	922.5	444.5	1012.9	2770.6	642.0	1017.7	568.0	153.0	244.0	72.7	8277.2
United Kingdom	59.0	535.7	978.2	301.1	1895.9	6321.9	3390.6	5473.6	3171.0	508.0	3574.0	724.0	26933
Japan	2240.8	929.3	1510.6	836.1	1562.5	3781.8	7655.3	5421.3	882.0	644.0	1962.0	790.0	28215.7
Singapore	265.2	346.4	465.1	1460.2	6312.7	1508.7	3131.0	2298.7	1175.0	731.0	536.0	1131.0	19361
Taiwan	618.3	1057.3	563.3	131.4	2487.6	567.4	534.6	3419.4	112.0	1489.0	131.0	72.0	11183.3
Germany	13.5	59.9	36.7	120.6	113.1	1344.6	164.9	4467.8	70.0	86.0	959.0	43.0	7479.1
France	68.7	25.8	19.9	158.0	37.1	498.3	70.7	456.6	3.0	23.0	67.0	14.0	1442.1
Republic of Korea	722.9	301.3	618.3	661.4	1849.0	674.7	1231.4	1409.9	232.0	221.0	689.0	357.0	8967.9
Netherland	567.2	183.6	96.2	311.4	165.7	360.0	1329.5	319.5	411.0	50.0	1158.0	89.0	5041.1
Hong Kong	993.3	277.7	1020.9	384.1	6041.7	1763.3	1105.7	251.0	948.0	78.0	105.0	40.0	13008.7
Others	3048.5	4785.4	4091.5	3335.4	5875.1	20353.4	10672.8	9297.0	6013.5	6909.2	6001.2	11710.7	92093.7
Total	**8751.1**	**8778.0**	**10323.2**	**8144.2**	**27353.3**	**39944.7**	**29928.5**	**33832.5**	**13585.5**	**10892.2**	**15426.2**	**15043.4**	**222002.8**

Source : World Investment Directory and World investment Report (Various issues)

Notes : Data on FDI we on approval basis and has been transferred from the exchange rates taken from the International Financial statistic (Year Book), IMF, 2003

$72.7 million that is 0.5 per cent of the total foreign direct investment flows in the year 2001. The share of UK has been increased from US $59.0 million that is 0.7 per cent in total foreign direct investment flows in 1990 to US $724.0 million that it becomes 4.8 per cent of the total foreign direct investment flows in the year 2001. The share of Singapore has been increased form US $265.2 million that is 3.0 per cent of total foreign direct investment in 1990 to US $1131.0 million that it becomes 7.5 per cent of the total foreign direct investment flows in the year 2001. Further, the share of the Taiwan, South Korea and Hong-Kong has been decreased from US $8618.3 million, US $722.9 million and US $993.3 million in 1990 to US $72.0 million US $357.0 million and US $40.0 million respectively in the year 2001.

Country-Wise Break-Up of FDI With Selected Statistical Values

We have analysed the country-wise break-up of foreign direct investment in Indonesia which shows that there is almost a fluctuating trends in foreign direct investment flows during the period 1990-2001. The country-wise flows of foreign direct investment together with the compound rate of growth and other values can be had from the Table 3.5(b), during the period 1990-2001.

It can be observed from the Table 3.5(b) that the compound rate of growth of foreign direct investment during the period 1990 – 2001, was 5.13 per cent per annum. The top five countries which contributed in the highest compound rate of growth includes Hong-Kong with 26.65 per cent, England with 20.95 per cent, Germany with 19.05 per cent, Taiwan with 13.23 per cent and France with 8.05 per cent per annum.

The top five countries in terms of foreign direct investment flows includes Japan, England, Singapore, Hong-Kong and Taiwan and together they account for the 44.5 per cent Table 3.5(a) of the foreign

Table 3.5(b)

Country - Wise Break - Up of Foreign Direct Investment in Indonesia With Selected Statistical Values During 1990-2001

Country	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression. Coefficient	R-Squared	CRG (%) Per Year
USA	72.70	2770.60	689.77	738.53	107.07	Ln (USA)	6.58390 (10.33509)	-.07737 (.89395)	.074	8.04
United Kingdom	59.00	6321.90	2244.42	2121.69	94.53	Ln (UK)	5.85092 (7.51875)	.19022 (1.79906)	.245	20.95
Japan	644.00	7655.30	2351.31	2193.50	93.29	Ln (Ja)	7.57274 (14.56985)	-.02099 (.27407)	.009	2.12
Singapore	265.20	6312.70	1613.42	1705.51	105.71	Ln (Sing)	6.52762 (11.19628)	.06874 (.86780)	.070	7.12
Taiwan	72.00	3419.40	931.94	1051.09	112.79	Ln (Tw)	7.00436 (9.15218)	-.12429 (1.19526)	.125	13.23
Germany	13.50	4467.80	623.26	1282.80	205.82	Ln (Ger)	3.85505 (3.83853)	.17438 (1.27794)	.140	19.05
France	3.00	498.30	120.18	172.11	143.21	Ln (Fr)	4.40465 (4.77486)	-.07740 (.61755)	.037	8.05
Republic of Korea	212.00	1849.00	747.30	505.80	67.68	Ln (RK)	6.70093 (15.48934)	-.04534 (.77139)	.056	4.64
Netherlands	50.00	1329.50	420.09	414.61	98.70	Ln (Neth)	5.69194 (8.80878)	-.01298 (.14793)	.002	1.31
Hong Kong	40.00	6041.70	1084.06	1650.50	152.25	Ln (HK)	7.67559 (10.20926)	-.23629 (2.31318)	.349	26.65
Total (Inclusive Others)	8144.20	39944.70	18500.23	11164.23	60.35	Ln (TT)	9.34351 (26.54877)	0.5005 (1.04684)	.099	5.13

Note : Figure in Parenthesis Show t - values.

direct investment flows had a coefficient of variation (at 93.29 per cent, 94.53 per cent, 105.71 per cent, 152.25 per cent and 112.79 per cent respectively) during the period 1990 – 2001. But the average compound rate of growth for the above mentioned period was merely 14.01 per cent. The highest coefficient of variation among the top ten countries has been found to be with Germany by 205.82 per cent showing highest inconsistency, whereas South Korea with 67.7 per cent coefficient of variation is having the strong stability in the foreign direct investment flows.

Sector-Wise Break-Up of FDI Flows

The sector-wise break-up of foreign direct investment as presented in Table 3.6(a) shows the fluctuating trends over the year 1990 – 2001. The top five sectors which attracted largest amount of foreign direct investment during 1989 was chemical and chemical products, textiles, leather and clothing, basic metals and metal products, wood and food, beverages and tobacco and together they account for the 86 per cent of the total foreign direct investment flows, whereas in the year 2001 the top five sectors were chemicals and pharmaceuticals industry, hotel and restaurants, paper printing and publishing, basic metal, engineering and electronics, transportation, storage and communication and together they account for the 33 per cent of the total foreign direct investment flows.

The flows of foreign direct investment in the chemical and chemical products has been increased from US $1762.1 million that is 20.1 per cent in 1990 to US $7405 million that is 48 per cent in 1996 to US $2263 million that it becomes only 15.4 per cent of the total foreign direct investment flows in the year 2001. This has been followed by the basic metal and metal products whose share has been increased from US $1285.5 million that is 14.7 per cent in 1990 to a peak of US $3589.5

Table 3.6 (a)
Sector-Wise Break-Up of Foreign Direct Investment in Indonesia During 1990 – 2001

(US $Million)

Sectors/Years	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
Agriculture, hunting, Forestry and Fishing	189 4	25 9	231 4	160 1	729 9	1384 2	1521 6	463 7	987 5	493 2	444 1	383 0	7014 0
Chemical and Chemical Products	1762 1	920 8	2342 6	1182 8	7743 2	1940 4	7404 6	12376 4	6179 0	3269 0	7405 0	2263 0	54788 9
Food, beverages and Tobacco	98 9	381 9	212 8	141 1	1234 8	1331 8	691 4	572 8	342 0	681 9	702 2	277 0	6668 6
Textiles, Leather and Clothing	1083 2	532 4	591 3	419 4	396 4	471 1	514 6	372 6	216 9	241 2	407 5	327 0	5573 4
Wood including Wood products and Paper	1211 0	884 2	719 9	251 8	8817 2	2803 5	3008 4	5423 0	112 0	1527 0	246 0	64 0	25068 0
Basic metal and Metal Products	1286 5	1053 3	909 4	1299 9	3504 7	2549 8	3589 5	2688 7	1286 0	1093 0	1839 0	642 0	21741 8
Electricity and Water distribution	0 0	0 0	0 0	2275 6	2397 2	3549 3	3808 5	1839 9	1795 4	2310 0	0 4	1817 0	19793 3
Transport, Storage and Communication	803 0	166 9	14 2	85 4	145 1	5539 5	694 6	5900 0	79 0	102 8	1218 7	178 0	14927 2
Real Estate	894 2	402 7	715 8	598 0	1027 8	1222 0	3000 3	1397 6	1311 7	171 1	301 6	177 4	11220 3
Hotel and Restaurant	864 3	4019 0	419 2	394 4	343 6	998 8	1716 5	462 6	449 6	229 5	259 8	865 0	11022 3
Others	558 5	390 9	4166 6	1335 7	1013 4	18154 3	3978 5	2335 2	826 4	773 5	2601 9	8050 0	44184 9
Total	**8751.1**	**8778.0**	**10323.2**	**8144.2**	**27353.3**	**39944.7**	**29928.5**	**33832.5**	**13585.5**	**10892.2**	**15426.2**	**15043.4**	**222002.8**

Source World Investment Directory and World Investment Report (Various issues)

Note Data on FDI are on Approval basis and has been transferred from the exchange rates taken from the International Financial Statistics (Year Book), IMF, 2003

2001. This sector has been followed by the electricity and water distribution in which the total amount has been increased from US $2275.6 million that is 28 per cent of the total foreign direct investment flows in 1993 to US $1817 million that it becomes only 12.1 per cent of the total foreign direct investment flows in the year 2001. The above sector has been followed by hotel and restaurants in which the total amount of foreign direct investment has been increased from US $8643 million that is 9.9 per cent in the 1990 to US $865.0 million that it becomes 5.6 per cent of the total foreign direct investment flows in the year 2001. This has been followed by agriculture, hunting forestry and fishing with their share as 2.5 per cent, textiles, leather and clothing with their share as 2.2 per cent, food beverage and tobacco with their share as 1.8 per cent in the total foreign direct investment flows in the year 2001.

Sector-Wise Break-Up of FDI With Selected Statistical Values

In the preceding section we have analysed the sector-wise break-up of foreign direct investment in Indonesia which is showing inconsistency in foreign direct investment flows during the period 1990-2001.

The sector-wise break-up of foreign direct investment together with the compound rate of growth and other values can be had from the Table 3.6(b), during the period 1990-2001. The table depicts that the compound rate of growth of foreign direct investment during the period 1990 – 2001, was 5.13 per cent per annum. It can be stated that the top five sectors which have contributed in the highest compound rate of growth includes electricity and water distribution with 61.03 per cent, agriculture, hunting, forestry and fishing with 17.63 per cent, wood products with 16.64 per cent, chemicals with 12.96 per cent and food industry with 10.57 per cent per annum.

Table 3.6 (b)

Sector-Wise Break-Up of Foreign Direct Investment in Indonesia With Selected Statistical Values During 1990-2001

Sectors	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per Year
Agriculture, hunting, forestry and Fishing	25 90	1521 60	584 50	482 17	82 49	Ln (AHF)	4 89854 (7 96568)	16241 (1 94375)	274	17 63
Chemical and Chemical Products	920 80	12376 40	4665 74	3583 23	78 48	Ln (CK)	7 32843 (15 82258)	12188 (1 93678)	273	12 96
Food, beverages and Tobacoo	98 90	1234 80	455 88	334 04	73 27	Ln (FBT)	5 20472 (11 40554)	10044 (1 62849)	210	10 57
Textiles, Leather and Clothing	216 90	1083 20	464 47	224 51	48 34	Ln (Txt)	6 62830 (37 30105)	- 8829 (3 65695)	572	9 23
Wood including wood products and Paper	64 00	8817 20	2089 00	2544 62	126 60	Ln (W)	7 77873 (8 30349)	- 15395 (1 21828)	129	16 64
Basic metal and metal products	642 00	3589 50	1811 82	1019 34	56 26	Ln (BMP)	7 40270 (20 70196)	- 00646 (0 13313)	002	0 65
Electricity and water distribution	0 00	3808 50	1647 94	1368 44	83 04	Ln (EW)	10 61872 (3 51957)	- 47639 (1 32736)	201	61 03
Transport, Storage and Communication	14 20	5900 00	1243 93	2124 43	170 78	Ln (TSC)	5 21004 (4 52805)	08331 (53291)	028	8 69
Real Estate	171 10	3000 30	935 02	781 47	83 58	Ln (RE)	7 08242 (13 42850)	- 8624 (1 20344)	1 27	9 01
Hotel and Restaurant	229 50	4019 00	918 53	1064 00	115 84	Ln (HR)	7 04791 (14 35423)	- 09359 (1 40300)	165	9 81
Total (Inclusive Others)	**8144.20**	**39944.70**	**18500.23**	**11164.23**	**60.35**	**Ln (TT)**	**9.34351 (26.54877)**	**.05005 (1.04084)**	**.099**	**1.05**

Note Figures in Parenthesis show-t values

The top five sectors which have attracted the bulk of foreign direct investment flows were chemicals, wood products, basic metals, electricity and water distribution, transport industry and together they account for the 61.40 per cent Table 3.6(a) had a coefficient of variation (at 78.48 per cent, 126.60 per cent, 56.26 per cent, 83.03 per cent, 170.78 per cent respectively) during the period 1990 – 2001. But the average compound rate of growth for the above sector is merely 20 per cent during the above mentioned period. The highest variation among the top ten sectors has been found to be with the transport industry having 170.78 per cent coefficient of variation showing highest inconsistency whereas the strong consistency has been found to be with textiles industry having 48.13 per cent coefficient of variation.

3. FOREIGN DIRECT INVESTMENT IN THAILAND

3.1 Government Policy

Thailand is one of the most open economies among the developing countries. It was primarily an agricultural economy and its share to GDP continually declined and that of manufacturing sector increased over the years. Today, Thailand is considered to be the most attractive investment location in South- East-Asia and is widely touted to become the fifth tiger of Asian Newly Industrialized economies. Its political stability, private entrepreneurship, cheap labour, positive attitude towards foreign investment and financial policies have contributed to this image, despite continuing problems with inadequate physical infrastructure and inefficient public bureaucracy. Thailand, is also a prime Asian beneficiary of international realignments in currency exchange rates and accompanying changes in comparative advantage, which have induced

many of the more labour intensive Japanese and Taiwanese manufacturing industries to relocate operations here.

Before 1960, Thailand received most of the foreign investment in the sectors mostly for exporting primary commodity such as plantations and tin mines in the South and in the export activities dominated by Chinese merchant capital and European agency houses. In the early 1960, there were some local investors who opposed foreign investment but the big domestic capitalists and particularly the banks and their industrial allies were very much in favour of increased foreign investment and it was this latter group, which had most political influence (Hewison 1985). Foreign investors were allowed selectively in those sectors where the local capital was inadequate. The import substituting joint venture firms were given promotional privileges in the early 1960s and early 1970s. The typical foreign project was a manufacturing joint venture between a Japanese company and a Sino-Thai partner producing for the local market behind tariff walls. Foreign investors were generally kept out of financial sector. Besides, providing incentives to the private sector (both foreign and local). Thai state promoted industrialization by suppressing organized labour.[23]

The major emphasis is given to those projects that contribute to the BOP solution, regional development energy conservation, linkage creation, employment and technology transfer. Majority foreign ownership is permitted for export oriented firms, but majority local ownership is required for firms producing for the domestic markets with 51 per cent local equity requirements in manufacturing for the domestic market and a 60 per cent local equity requirements for a project in agriculture, animal husbandry, fishing, mineral exploration and services.

The tax incentives granted to promoted firms includes exemption from corporate income tax and exemption or reduction of import duties and business taxes or imported machinery and equipment, raw materials and components. The export promotion Act of 1972 provides for full tax exemption on import of inputs, which are used in the process of export production. Additional incentives are given to firms willing to locate outside the overcrowded Bangkok metropolitan areas.

In September 1987, tax holidays and incentives were reduced for investment projects to be setup in the greater Bangkok area, making decentralisation a key objective of investment promotion.[24] The Board of Investment (BOI) is required to monitor most aspects of promoted investment activities such as technology transfer, creation of supply linkages and skill obtaining. It incentives are equally available to foreign and to local capital which infact invested in promoted industries. Along with foreign investment measures, foreign borrowings are also welcomed. This has resulted in a huge increase of private and public sector borrowings especially during the late 1960s and to early 1980s.[25] In the late 1980s, external borrowings has slowed and foreign direct investment flows have increased dramatically as Thailand increasingly attracts export oriented manufacturing investment, especially from Japan and the Asian NIEs. In the year 1980, public sector (aid) inflows and other private inflows (mostly commercial loans) accounted for 90 per cent of all net capital inflows and by 1988 public flows had slowed to a trickle and commercial loans were down to about a third net capital inflows. The inflows of direct investment more than tripled between 1980 and 1988 when it reached baht 12.3 billion. In 1987, before the large influx of direct investment in 1988 portfolio investment accounted for 61 per cent of total net inflows. Over the years, the flows of foreign direct investment

have increased but its contribution to domestic capital formation is still very small as compared to the local capital. The local capital has been benefited due to the favourable state policy, access to foreign technology through joint venture and because of its own size and dynamism and long established ability to influence state policy in its favour. In addition, numerous incentives were provided to industries, which have been granted "promoted" status by the office of the Board of Investment. Firms, establishing in Export Processing Zones (EPZs) or in industrial estates are granted additional incentives. Since 1993, emphasis has been shifted from export promotion to industrial decentralization, to encourage companies to establish or relocate in areas outside Bangkok and neighbouring provinces. Foreign investors participating in manufacturing projects mainly for the domestic market are permitted a maximum ownership stake up to 49 per cent of registered capital, except for projects located in northern part of the country where majority or wholly foreign owned projects are allowed. They are allowed to hold a majority of the share if they export 50 per cent of their output and are also provided wholly ownership if they export 80 per cent of their total output. The shareholding limit for foreign investment in priority areas has been waived out. The 1997, financial crises has further liberalized its stance towards foreign investment, which includes the lifting of foreign shareholding limits on Thai banks and finance and credit companies from 25 per cent of paid up foreign capital to 100 per cent within a limit frame of 10 years. Moreover, short term investment measures launched in November 1998, authorized majority or wholly foreign ownership for new manufacturing projects located in Bangkok areas and southern part of the country.[26]

The BOI in Thailand is primarily for granting tax incentives over which it has discretionary authority. The BOI has identified three promotional Zones, namely Zone 1, Zone 2, Zone 3. Some of the incentives under the above three zone are as follows.[27]

Zone 1, Incentives include among others.

- A corporate income tax exemption for three years provided the projects export not less than 80 per cent of its total sales and locates its factories in industrial estates or promoted industrial zones.
- Exemption of import duty on machinery to be used in a new project provided the project exports not less than 80 per cent of its total sales and locates its factories in industrial estates or promoted industrial zones.
- Exemptions of import duty on raw materials used in export products for a period of one year provided that 30 per cent of sales are exported.

Zone 2, incentives include among others.

- A corporate tax exemption for three years, which may be extended to 7 years provided that projects locates its factories in industrial estates or promoted industrial zones.
- A 50 per cent reduction in import duty on raw materials used in export products for a period of one year provided that 30 per cent of output is exported.

Zone 3, incentives include among others.

- A corporate tax exemption for 8 years with a 50 per cent reduction in the corporate income tax for an additional period of five years.
- Exemptions from import duty on raw materials used in export products for a period of 5 years provided 30 per cent of output is exported.
- A 75 per cent reduction in import duty on raw materials used in the production for domestic sales for a period of 5 years.
- A double tax deduction for water, electricity and transport costs for 10 years from the date of the first sale.
- An additional 25 per cent deduction for costs associated with developing certain infrastructure facilities connected with the project.

In addition to BOI, the industrial state authority of Thailand provides further incentives in respect of projects located in Economic Promotional Zones. The BOI has also given autonomy to grant special privileges to high technology projects. It has also carried out tax treaty agreement to avoid double taxation among 40 countries. This generally favours tax payers in a better position, provided that profit will only be taxable if the tax payers has a permanent establishment in Thailand.[28]

3.2 Trends in FDI Flows

Thailand is one of the developing countries, which has attracted the bulk of FDI due to their liberal attitude inspite of its socio-economic build-up.

Table 3.7
Foreign Direct Investment in Thailand: Approvals vs Actuals During 1990-2001

(US $ Million)

Years	Approvals	Actuals	% Growth (Actuals)
1990	18563.7	2562.0	
1991	10859.7	2030.0	20.8
1992	10842.1	2114.0	4.4
1993	6964.9	1805.0	-14.6
1994	9988.8	1364.0	-24.4
1995	23282.5	2068.0	51.6
1996	20960.3	2271.0	9.8
1997	15345.4	3626.0	59.7
1998	7335.4	5143.0	41.8
1999	3598.1	3561.0	-30.8
2000	5301.4	2813.0	-26.7
2001	4636.6	3759.0	33.6

Source : World Investment Directory and World Investment Report (Various Issues)

The amount of foreign direct investment (Table 3.7) has increased from US $2562.0 million in 1990 to US $3759.0 million in the year 2001. FDI flows scenario in Thailand is quite uneven with many ups and downs in their growth rate. The differences between approval and actuals has come down especially since 1998, and it has enabled Thailand to realized a 33.6 percentage rate of growth in the year 2001.

Country-Wise Break-Up of FDI Flows

The country-wise break-up of foreign direct investment Table 3.8(a), shows that there is a declining trend in Thailand over the period 1990 – 2001. The important features are that all the leading countries have shown a declining trends over the years. During the period 1990 –

Table 3.8(a)
Country - Wise Break - Up of Foreign Direct Investment in Thailand During 1990-2001

(US $Million)

Country / year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
USA	1091.0	1130.6	1233.1	431.1	1308.8	2582.2	2766.4	2859.1	556.6	1225.8	941.2	887.7	17013.7
Japan	2705.9	1759.9	1967.4	2705.3	2555.7	7891.4	6190.8	5209.4	1643.2	715.1	2677.1	1844.0	37865.2
Taiwan	764.8	571.7	291.1	210.4	474.6	1810.1	2747.5	414.4	256.5	209.2	439.6	150.9	8340.8
Hong Kong	7168.7	336.1	139.7	124.5	211.1	241.2	164.5	50.1	143.8	50.2	155.6	214.8	9000.3
Netherlands	154.1	255.9	2293.6	45.3	79.7	124.4	917.8	223.5	2138.0	594.5	157.8	81.8	7066.4
Germany	401.8	47.3	303.0	263.8	193.8	174.7	321.8	474.8	318.2	49.4	159.4	303.5	3011.5
Switzerland	66.0	1.5	29.7	70.9	53.7	100.3	103.8	48.5	44.5	83.8	56.9	56.3	715.9
Singapore	590.8	623.2	482.2	233.2	567.1	1527.4	1860.6	2332.3	296.1	185.2	496.4	19.8	9214.3
France	193.2	124.6	224.2	42.0	501.2	26.2	173.2	316.8	88.8	74.8	27.4	28.6	1821.0
United Kingdom	386.5	887.5	598.0	158.5	196.1	301.8	583.4	1488.6	763.7	103.6	145.0	107.3	5720.0
Others	5040.9	5121.4	3280.1	2679.8	3847.0	8501.8	5130.5	1927.9	1086.0	306.5	45.0	941.9	37908.8
Total	**18563.7**	**10859.7**	**10842.1**	**6964.9**	**9988.8**	**23181.5**	**20960.3**	**15345.4**	**7335.4**	**3598.1**	**5301.4**	**4636.6**	**137677.9**

Source : World Investment Directory and World Investment Report (Various issues).

Notes : Data on FDI are on Approval basis and has been transferred from the exchange rates taken from the International Financial Statistics (Year Book), IMF,2003.

2001, though there was a sharp decline in foreign direct investment from Japan, USA and Germany but they are continue to be the major investors in Thailand. In the year 1990, the top five investor in Thailand were Hong-Kong, Japan, USA, Taiwan and Singapore and together they accounted for the 64.3 per cent of total foreign direct investment flows whereas in the year 2001 the top five investors were Japan, USA, Germany, Hong-Kong and Taiwan and together they accounted for the 73.4 per cent of the total foreign direct investment flows.

The flows of foreign direct investment from the Japan has decreased from US $2705.9 million that is 14.6 per cent in 1990 to US $1844.0 million that it becomes 39.8 per cent of the total foreign direct investment flows during the year 2001. This has been followed by USA whose share was US $1091 million, which has been, decreased from US $1091 million that is 5.9 per cent in 1990 to US $877.7 million that it becomes 19.1 per cent in the year 2001. This has been followed by Germany with its share at 6.5 per cent, Hong-Kong with 4.6 per cent and Taiwan with 3.3 per cent in the total foreign direct investment flows in the year 2001.

Country-Wise Break-Up of FDI With Selected Statistical Values

Table 3.8(b), depicts the country-wise break-up foreign direct investment in Thailand showing that there is a declining trend during the period 1990 – 2001.

The country-wise break-up of foreign direct investment together with the compound rate of growth can be had from the Table 3.8(b), during 1990 – 2001. It can be shown that the compound rate of growth of foreign direct investment during the period 1990 – 2001 was 10.28 per cent per annum. The top five countries which contributed in the highest compound rate of growth includes Hong Kong with 21.91 per cent,

Table 3.8 (b)
Country - Wise Break - Up of Foreign Direct Investment in Thailand With Selected Statistical Values During 1990-2001

Country	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per Year
USA	431.20	2859.10	1417.81	839.22	59.19	Ln (USA)	7.10573 (18.616040	-.00094 (.01825)	.00003	.09
Japan	715.10	7891.40	3155.43	2135.75	67.69	Ln (JP)	8.04813 (19.31821)	-.02841 (0.50197)	.025	2.88
Taiwan	150.90	2747.50	695.07	785.73	113.04	Ln (Twn)	6.62369 (12.34058)	-.07527 (1.03220)	.96	7.82
Hong Kong	50.10	71468.70	750.03	2022.91	269.71	Ln (HK)	6.58893 (9.81343)	-.19810 (2.17153)	.321	21.91
Netherlands	45.30	2293.60	588.87	801.19	136.06	Ln (Neth)	5.50894 (6.61690)	.01256 (.11110)	.001	1.26
Germany	47.30	474.80	250.96	130.59	52.04	Ln (Ger)	5.3 4370 (11.03419)	-.00214 (.03214)	.0001	.021
Switzerland	1.50	103.80	59.66	28.67	48.05	Ln (Swit)	2.99504 (4.49053)	.12459 (1.37489)	.159	13.27
Singapore	19.80	2332.30	767.86	730.74	95.17	Ln (Sing)	7.04525 (9.42558)	-.14148 (1.39307)	.163	15.20
France	26.20	501.20	151.75	153.29	94.17	Ln (Fran)	5.45692 (9.49770)	-.13312 (1.70522)	.225	14.24
United Kingdom	103.60	1488.60	476.67	416.21	87.32	Ln (UK)	6.45454 (12.21488)	-.09814 (1.36703)	.158	10.31
Total	**3598.10**	**23281.5**	**11473. 16**	**66194.1**	**57.70**	**Ln (TT)**	**9.82129 (30.54758)**	**-.09787 (2.24051)**	**.334**	**10.28**

Note : Figures in Parenthesis show-t values.

Singapore 15.20 per cent, France 14.24 per cent, Switzerland 13.27 per cent and Britain 10.31 per cent during the period 1990-2001.

The top five countries in foreign direct investment flows were Japan, USA, Singapore, Hong-Kong and Taiwan and together they accounted for 59.12 per cent Table 3.8(a) has a coefficient of variation (at 67.69 per cent, 59.19 per cent, 95.17 per cent, 26.71 per cent and 113.04 per cent) during the period 1990 – 2001. But the average compound rate of growth for the above mentioned countries was 47.9 per cent. The highest coefficient of variation among the top ten countries have been found to be with Hong-Kong with 269.71 per cent, showing highest inconsistency whereas the lowest variation or more stability is found with Switzerland having 48.05 per cent coefficient of variation in total foreign direct investment flows during the period 1990 – 2001.

3.4. FOREIGN DIRECT INVESTMENT IN SINGAPORE

3.4.1 Government Policy

Singapore economy is one of the most open and dynamic in the third world. The rapid growth of the Singapore economy has been the result of the combination of private investment domestic and foreign and the active participation of the state in the economy. Foreign investment has played a major role in the Singapore economic development as an enter port for the whole South-East Asian region. The open door policy towards foreign investment and the greater competitiveness of the foreign firms in export market made Singapore today as probably the most heavily foreign dominated manufacturing sector in the world.

In 1959, Singapore new government has introduced the import substituting industrialization and tax holidays for "Pioneer firms" with other incentives. These measures were designed for local firms but most

were open to local and foreign investors through the Economic Development Board (EDB) under the Economic Expansion Incentives Act, which was first introduced in 1959.[29] Since 1960, the government has brought new investment, incentives to attract foreign investment. The basic incentive was and still is "Pioneer Status" which provides for exemption from the 40 per cent company income tax for a period of five to ten years depending on such factors as the level of investment, its employment of skilled labour, research and development and spending and so on.

The government has developed various institutions and investment incentives to attract foreign investment. The Economic Development Board was constituted in 1961, as a main agency responsible for Industrial development as well as promotion of foreign investment. After its separation from federation with Malaysia in 1965, the Singapore government sought to attract foreign investment in manufacturing and financial services through industrial policy and to tackle the problem of growing unemployment. The foreign investment policy has been liberalized and non interventionist except for a few industries. There were no limitations on equity ownership, no performance requirements, such as local content rules and the training of locals, no foreign exchange controls or limits on profit repatriation and technology transfer requirements or controls.[30]

Foreign investors are subject to the same requirements in terms of capital investment, levels of technology, establishment of research and training facilities etc. The introduction of Economic Expansion Incentives Act (EEIA) has given incentives to manufacturers in "Pioneer Industries" and to promote export. A product development policy, which provides a wide range of incentives to foreign and local industries, is created with

the transformation of the economy. The measure, which was first introduced in 1967, has been liberalized which encourages exports by taking export profits as 4 per cent rather than the usual rate of 40 per cent. The normal incentive period is five years but it can be extended for 15 years for projects with fixed capital expenditure of over $1 million provided, Singapore citizens own over 50 per cent of the paid-up capital. In 1977, all the remaining restrictions on foreign exchange were removed and a few import tariffs were imposed on luxury and non-essential food stuffs. Since 1979, the government has liberalized tax and investment incentives to encourage research and development activities, automation, mechanization and computerization in manufacturing firms trade and services. In 1984, further amendments were made to the EEIA, to provide benefits covering knowledge, skills, computer, related industries and research and development activities.[31] The three year accelerated depreciation allowance granted for manufacturing firms was also extended to non-manufacturing industries especially those engaged in the export of traded services. The tax incentive was available to both local and foreign firms equally. In 1986, "Pioneer Status" for counter trade firms were introduced in order to attract the foreign investments and to base their operations in Singapore. Since 1986, the government has taken steps to make Singapore even more attractive to foreign investors including those who want to use island as a services purchasing and operational head quarters centre. The government also offers incentives to promote Singapore as a financial centre. The Asian currency markets which was established during 1980s with special incentives to promote fund management has given additional advantages to it. Since 1989, EDB has developed new investment incentives, which focuses on improving the quality of investments in services, encourages small firms to upgrade

faster and local firms to go internationally, pushing for greater automation in manufacturing and focusing on biotechnology.[32]

In 1991, the National Technology Plan emphasized the promotion of prevalent research and development activities through such schemes as the research incentive schemes for companies, Research and Development Assistance scheme (RDAS), Manpower Development Assistance Scheme (MDAS), Patent Application Fund (PAF) and the Innovators Assistance Scheme (IAS).[33] The company which has got "Pioneer Status" is exempted from corporate tax on profits from pioneer activity up to 10 years".

A number of other provisions were;

1. The foreign companies are exempted from the income tax equal to specified percentage, not exceeding 50 per cent of the new investments in productive equipments.
2. The companies having overseas network has a concessionary tax rate of 10 per cent on income arising from the provision of approved services for related overseas companies from Singapore.
3. They have a full or partial exemption from withholding tax on interest payments.
4. The companies having venture capital provisions has been provided that in case of losses incurred from the sale of shares or the limitations of overseas investment up to 100 per cent of equity invested can offset against or investors others taxable income.
5. There are no restrictions on the convertibility of the currencies for the transfer of funds overseas.
6. There is no anti trust or other laws to regulate competition in Singapore. All industries and services are developed to enhance

national competitiveness. There is no provision of privatization of government services in order to maintain competitiveness.

7. The Singapore government sets out a high standard of compliance for the protection, enforcement and dispute settlement of trade related matters for WTO members and adhere to.
8. Singapore has institutionalized and internationlised arbitration, through the creation of international arbitration centre in 1990 and ratifications of international conventions.

The foreign investors who want to make investments in tourism projects have been given time frame during which they can make investments according to their amount. The measures have also been taken to develop Singapore into a global hub for life sciences to provide diversification to the domestic economy.

In spite of these incentives, there is a government owned companies and statutory boards involves in a wide range of manufacturing and services activities including iron and steel mills, textiles, electrical component, manufacture oil, refining, hotels, ship building, financial services and property development. Foreign investors are attracted to Singapore by a combination of factors of which probably the most important are political stability and the government reputation for honesty and efficiency and consistently positive attitude towards foreign investment.

The other favourable factors are,

- tax incentives and capital assistance
- no restrictions on import and export of goods
- the provision of most efficient and up to date infrastructure
- the adaptable, trainable and increasingly English speaking manpower

- fast growing supply of skilled and professional personnel
- industrial peace and cooperative unions, competent and helpful government agencies
- good living conditions for expatriates

The combination of above factors with many more incentives has created favourable climate for international investment. The foreign investment in Singapore has spurred growth and strengthened stability, reinforcing the island reputation as a profitable trouble free investment location.

The strong role of foreign investment in Singapore is largely also on account of the dominancy of multinationals over small local firms. The faster growth and higher wages, employment and profitable state revenue due to MNCs enable the state to do more than welfare means for the general masses. Singapore success in attracting foreign firms especially computer manufactures is as impressive as its previous success in attracting labour intensive electronic firms. The key factors underlying this success are business confidence, a factor greatly influenced by government policies. The quality of foreign investment in terms of skill and capital intensity has improved in recent years. The Singapore official policy is to welcome investment in the services and trading sectors (except retail trade in which there is abundant local expertise) especially technical, professional services that expand the island's role as a regional business centre. It is recognized that investment in services often leads to direct investment in manufacturing facilities. Although, it does not insist the government preference to have joint venture in large retail venture and investments in property and hotels. Further, there are a no licensing provisions, no controls and regulation and investors are free to import

capital, remit profits and repatriate capital. In short, the Singapore economy is very open and characterized by the absence of regulations on flow of capital and goods. Broad political and social consensus is sought to ensure that Singapore provides a politically and socially stable environment, attractive to foreign investors. The equity caps on financial services on foreign investment in any locally incorporated bank has been raised from 49 per cent to 70 per cent in the year 1998. In the telecommunications sector, foreign investment in any of the liberalized services is allowed up to a combined total of 73.99 per cent (49 per cent foreign direct Investment and 24.99 per cent indirect investment). Foreign ownership in electricity services is currently allowed only in electricity generation and supply, while in water services, foreign investment is allowed in all areas except the supply of potable water.[34]

The government provides a wide range of tax and non-tax incentives to companies and individuals choosing to invest in Singapore. Investment incentives are provided mainly by the Economic Development Board through the Economic Expansion Incentives (Relief from Income tax) Act (Cap 86) and the Income Tax Act (Cap 134). The incentives include corporate tax holidays for five and ten years, for companies with pioneer status; concessional tax rates of 13 per cent (rather than standard rate of 26 per cent) for up to ten years; exemption of taxable income of specified proportions (up to 50 per cent) on new fixed investments, and a concessional 10 per cent tax (instead of 26 per cent) for operational head quarters on income arising from the approved services. To promote regional cooperation in investment, the framework Agreement on Investment Area (AIA), was signed on October 1998.

Moreover, Singapore has become the member of MIGA and has also concluded double taxation treaties with 43 countries.[35]

3.4.2 Trends in FDI Flows

The new government in 1959 has brought several measures, which enabled Singapore as one of the highly attractive countries among the developing economies. The amount of foreign direct investment has been increased from US $5575 million in 1990 to US $8609 million in the year 2001. Although, the foreign direct investment has grown rapidly and become double in the year 2001, but its pace is quite uneven.

Country-Wise Break-Up of FDI Flows

Table 3.9(a), a present the country-wise break-up of foreign direct investment which shows that there, is almost increasing trends over the period 1990 – 2001. During the period 1990 – 2001, though there was a decline in foreign direct investment from USA and Japan but they continue to be the largest, source of FDI in Singapore. In the year 1990, the top five investors in Singapore were USA, Japan, Germany, United Kingdom and Netherlands and together they account for the 94. 3 per cent of the total FDI flows, whereas in the year 2001, the top five investors were USA, Japan, France, Italy and Germany and together they account for the 89 per cent of the total foreign direct investment flows.

The share of USA has been increased from US $582.0 million that is 47.6 per cent in 1990 to US $1773.2 million that is 48.3 per cent in the year 2001. This has been followed by Japan whose share has been increased from US $3907 million that is 31.9 per cent in 1990 to US $744 million that is 20.3 per cent in the year 2001. Further, France has

Table 3.9 (a)
Country - Wise Break - Up of Foreign Direct Investment in Singapore During 1990-2001

(US $Million)

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
USA	582.0	561.0	736.7	898.7	1605.1	1464.5	1656.7	1631.6	1370.1	2116.0	2141.6	1773.2	16537.2
Japan	390.7	412.8	526.7	482.4	598.3	813.1	1391.5	1368.5	1088.8	696.1	877.6	744.4	9390.9
France	33.3	43.5	21.0	77.3	35.4	99.1	41.9	182.9	82.7	56.7	230.7	283.1	1187.6
Italy	0.0	40.6	16.4	26.8	25.5	9.3	38.2	117.9	53.7	50.0	104.6	270.3	753.3
Germany	91.4	34.8	65.3	126.6	60.1	129.7	174.8	81.7	312.3	372.1	217.7	198.1	1864.6
Netherlands	40.1	125.1	26.3	4.8	115.0	276.7	367.2	259.1	26.3	100.3	220.2	172.8	1743.3
United Kingdom	49.6	108.0	187.5	221.4	343.8	544.4	282.0	299.8	5.1	54.1	185.5	56.8	2338.0
Switzerland	18.0	7.3	38.7	41.0	7.5	9.3	42.6	17.0	91.9	15.6	29.8	7.2	325.9
Sweden	3.9	0.7	11.8	3.1	0.0	0.0	0.0	0.0	14.5	5.0	2.3	0.3	41.6
Others	14.7	90.8	47.3	84.2	42.5	78.0	113.8	58.0	69.8	215.6	186.8	165.6	1167.1
Total	**1223.7**	**1424.6**	**1677.7**	**1966.3**	**2833.2**	**3423.5**	**4107.7**	**4016.5**	**3115.2**	**3691.5**	**41.96**	**3671.8**	**35348.5**

Source : World Investment Directory and World Investment Report (Various issues)

Notes : Data on FDI are on Approval basis and includes only manufacturing sector and has been transferred from the exchange rates taken from the International Financial Statistics (Year book), IMF 2003.

followed this with its share at 7.7 per cent, Germany with 7.4 per cent during the year 2001.

Country-Wise Break-Up of FDI With Selected Statistical Values

Table 3.9(b), shows the country-wise break-up of foreign direct investment in Singapore which shows that there is an increasing trends during the period 1990 – 2001. The country-wise break-up of foreign direct investment together with the compound rate of growth and other values can be had from the Table 3.9(b), during the period 1990 – 2001.

It can be observed from the above table that the compound rate of growth of foreign direct investment during the period 1990 – 2001 was 11.39 per cent per annum. The top five countries which were having the highest compound rate of growth were Italy with 23.02 per cent, France with 19.07 per cent, Germany with 16.19 per cent, and Netherlands with 15.09 per cent and USA with 12.61 per cent per annum. The top five countries in terms of foreign direct investment flows were USA, Japan, United Kingdom, Germany and Netherlands and together they accounted for the 90.2 per cent Table 3.9(a), of the foreign direct investment flows had a coefficient of variation (at 40.50 per cent, 44.04 per cent, 80.12 per cent, 67.34 per cent, and 79.67 per cent) during the period 1990 – 2001. But the average compound rate of growth for the above mentioned countries was merely 12.24 per cent per annum. The highest coefficient of variation among the top ten countries has been found to be with the Sweden with 140.50 per cent, showing the highest inconsistency whereas the lowest variation has been found with the USA, with 40.50 per cent coefficient of variation, showing highest consistency in foreign direct investment flows during the period 1990 – 2001.

Table 3.9(b)
Country-Wise Break-Up of Foreign Direct Investment in Singapore With Selected Statistical Values During 1990-2001

Country	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per Year
USA	561.00	2141.60	1378.10	558.17	40.50	Ln (USA)	6.36188 (44.82612)	.11880 (6.16083)	.792	12.61
Japan	390.70	1391.50	782.58	344.65	44.04	Ln (JP)	6.05565 (29.25913)	.08014 (2.84990)	.448	8.34
France	21.00	283.10	98.97	86.12	87.02	Ln (Fr)	3.14204 (9.18231)	.17452 (3.75372)	.585	19.07
Italy	0.00	270.30	62.78	74.36	118.46	Ln (Italy)	.23511 (.46406)	.20718 (3.15114)	.523	23.02
Germany	34.80	372.10	155.38	104.63	67.34	Ln (Ger)	3.85340 (13.01951)	.15008 (3.73222)	.582	16.19
Netherlands	4.80	367.20	145.28	115.74	79.67	Ln (Neth)	3.51150 (4.67299)	.14831 (1.45266)	.174	15.99
United Kingdom	5.10	544.40	194.83	155.90	80.12	Ln (UK)	5.30493 (6.64627)	-.07784 (0.71778)	.049	8.09
Switzerland	7.20	91.90	27.16	24.46	90.06	Ln (Swit)	2.87998 (5.34013)	.01480 (0.20197)	.004	1.49
Sweden	0.00	14.50	3.47	4.87	140.50	Ln (Swe)	1.43676 (1.56577)	-.05726 (0.48138)	.037	5.89
Total	**1223.70**	**4196.80**	**2945.71**	**1097.99**	**37.27**	**Ln (Total)**	**7.20654 (52.56232)**	**.10790 (5.70236)**	**.770**	**11.39**

Source : Figures in Parenthesis Show t – values.

Sector-Wise Break-Up of FDI Flows

The sector-wise break-up of foreign direct investment Table 3.10(a) below, asserts almost similar pattern. The top five sectors which has attracted the largest amount of foreign direct investment in 1990 were the electronic products, petroleum products, chemicals, machinery equipment and transport equipment and together they accounted for the 86.8 per cent Table 3.10(a), of the total foreign direct investment flows during 1990 and remain almost the same even in the year 2001.

The other individual sector which have attracted the largest amount of foreign direct investment is the electronic products whose share has been increased from 60.61 that is million 44 per cent in 1992 to US $2562.6 million that is 50.3 per cent in the year 2001. This has been followed by chemicals whose share has been increased from US $166.0 million that is 12.1 per cent in 1990 to US $1093.9 million that is 21.5 per cent in the year 2001. Likewise, the other sectors shares are petroleum products with 6.9 per cent, machinery and equipment with 5.5 per cent and transport equipment with 4.3 per cent.

Sector-Wise Break-Up of FDI With Selected Statistical Values

We have analysed the data of sector-wise break-up of foreign direct investment during 1990 – 2001, which shows the rising trends over the years. The sector-wise break-up of foreign direct investment together with the compound rate of growth can be had from the Table 3.10(b) below, during the period 1990 – 2001. Table 3.10(b), depicts that the compound rate of growth of foreign direct investment during the period 1990 – 2001 was 13.03 per cent per annum. It can be stated form the Table 3.10(b), that the highest compound rate of growth of foreign direct investment inflows among the top five sectors were chemicals with 20.22 per cent, instrumentation equipment with16.33 per cent, electronic product with 15.56 per cent, petroleum with 13.23 per cent, basic metal and metal products with 9.67 per cent during the period 1990-2001.

Table 3.10(a)

Sector - Wise Break - Up of Foreign Direct Investment in Singapore During 1990-2001

(US $Million)

Sectors / Years	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
Electronic products and Components	606.1	719.7	771.8	759.6	990.8	1800.0	2466.4	2563.2	1821.2	1941.4	2581.9	2562.6	14584.7
Chemical and Chemical products	166.0	331.9	333.1	695.6	855.5	1117.5	1953.8	1508.4	1741.0	1557.2	1623.8	1093.9	12977.7
Petroleum and petroleum Products	210.2	57.6	278.8	52.2	772.8	837.0	76.8	391.5	15.8	3.5	56.7	352.2	3105.3
Machinery and Equipment	110.3	170.5	195.9	181.6	147.0	233.5	217.2	218.0	266.2	287.2	252.3	278.2	2557.9
Transport Equipment	99.2	71.9	102.6	211 2	363 6	209.2	177.3	242.4	213.6	187.2	257.4	221.3	2356 6
Instrumentation Equipment	11 6	19.7	84.9	70.4	17.3	34.9	58.6	47.2	26.4	219.9	60.0	147.1	798.0
Non-metallic Mineral Products	5.0	34.3	195.9	78.0	135.4	30.4	60.0	57.7	19.2	23.4	44.7	0.0	684.0
Basic metal and Metal Products	64.7	89.1	82.1	142.5	167.7	241.5	255.3	322.3	213.6	185.2	234.7	133.2	2131.9
Food beverages and Tabacco	24.2	18.4	47.0	57.6	23.8	65.3	142.8	96.0	78.2	149.6	0.5	12.9	716.3
Rubber and Plastic products	18.8	64.0	68.4	32.6	22.4	20.2	73.0	66.1	98.1	49.9	41.4	130.4	685.3
Others	56.3	121.2	23.6	146.2	277.8	214.4	252.9	204.1	184.9	137.1	188.2	163.6	1970.3
Total	**1372.4**	**1698.3**	**2136.9**	**2427.7**	**3774.1**	**4803.9**	**5734.1**	**57134.1**	**4678.2**	**4741.6**	**5341.6**	**5095.4**	**47521.1**

Source · World Investment Directory and World Investment Report (Various issues).

Notes · Data on FDI are on Approval basis and includes manufacturing sector with domestic investment and has been transferred from the exchange rates taken from the International Financial Statistics (Year Book), IMF, 2003.

Table 3.10 (b)

Sector - Wise Break-Up of Foreign Direct Investment in Singapore With Selected Statistical Values During 1990-2001

Sectors	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per Year
Electronic products and Components	606 10	2581 90	1632 06	813 99	49 88	Ln (EPC)	6 31888 (3 98019)	14458 (6 70285)	818	15 56
Chemical and Chemical Products	166 00	1953 80	1081 48	607 53	56 18	Ln (CH)	5 56454 (19 8442)	18416 (4 83380)	700	20 22
Petroleum and Petroleum Products	3 50	837 00	258 78	287 45	111 08	Ln (PP)	5 52393 (5 44731)	- 12423 (90167)	075	13 23
Machinery and Equipment	100 30	287 20	213 16	54 42	25 53	Ln (MF)	4 88681 (52 43398)	062784 (5 35755)	742	7 12
Transport Equipment	71 90	363 60	196 41	79 37	40 41	Ln (TE)	4 66551 (20 217966)	08107 (2 51578)	401	8 44
Instrumentation Equipment	11 60	219 90	66 50	61 12	91 91	Ln (IC)	2 86763 (6 48177)	15122	388	16 33
Non-metallic Mineral Products	0 00	195 90	57 00	57 03	100 05	Ln (NMP)	3 68508 (5 41247)	00943 (09401)	001	0 95
Basic metal Mineral products	64 70	322 30	177 66	79 01	44 48	Ln (BMP)	4 47426 (18 35349)	09228 (2 78610)	437	9 67
Food beverages and Tabacco	50	149 60	59 69	49 35	82 68	Ln (FBT)	4 07196 (4 17429)	- 08660 (0 65343)	041	0 05
Rubber and Plastic Products	18 80	130 40	57 11	33 70	59 02	Ln (RPP)	3 30097 (9 38495)	08816 (1 84486)	254	9 22
Total (Inclusive Others)	1372 40	5734 10	3960 09	1617 75	40 85	Ln (TT)	7 38533 (44 92543)	12246 (5 48267)	750	13 03

Note Figures in Parenthesis show t – values

The top five sectors which have attracted the bulk of foreign direct investment were namely electronic products, chemicals, petroleum, machinery equipment and transport equipment and together they account for 74.9 per cent Table 3.10(b) had a coefficient of variation (at 49.88 per cent, 56.18 per cent, 11.68 per cent, 25.53 per cent and 40.41 per cent) during the period 1990 – 2001. But the average compound rate of growth for the above mentioned sectors were merely 12.93 per cent during the aforesaid period.

The highest coefficient of variation among the top ten sectors has been found to be with the petroleum products with 111.08 per cent, showing the strong inconsistency whereas the lowest variations is found with transport equipment having 40 per cent showing the highest consistency in foreign direct investment flows during the period 1990 – 2001.

3.5. FOREIGN DIRECT INVESTMENT IN MALAYSIA

3.5.1 Government Policy

Malaysian economy is one of the most open and fastest growing economies among the developing countries. Foreign direct investment has played a significant role in the economic development of the country not only in terms of growth of gross domestic product but also in terms of structural changes that have transferred Malaysia from basically a primary producer into an industrialized economy.

After getting independence in 1957, Malaysia followed a free-enterprise economy and foreign investment has been encouraged in tariff protected, import substituting, manufacturing as well as in export oriented agriculture.[36] Foreign investment has been encouraged as an important means to promote industrial growth through technology transfer, skill

development and better access to foreign markets. The numerous fiscal and other incentives were offered to both foreign and private investors. The guidelines and regulations governing foreign investment in conformity with the countries development priorities and overall socio-economic objectives were brought up.

The laissez-fiare policy continued after the establishment of federation with Singapore in 1963, and persisted even after the withdrawal of Singapore from the federation in 1965.[37] The separation from federation and other factors resulted in many problems including the racial riot after the general election of 1969. As a consequence, the Malay dominated government has enacted a New Economic Policy in 1970, with the prime aim to restructure Malaysian society and to eliminate the identification race with new economic function and geographical location and to eradicate poverty in all ethnic groups. The introduction of the NEP aimed at decreasing the ownership share of foreign capital and that of increasing the local share. It was designed as a means to redistribution of growth in output and employment rather than redistribution of existing output and employment opportunities. Instead, the state agencies and enterprises have favoured foreign investment and established Free Trade Zones (FTZs) where 100 per cent foreign ownership of export oriented firms is permitted and such firms are granted long term tax holidays. The state enterprises have gone into the Joint ventures with foreign investors. In the export oriented manufacturing, particularly in electronics 100 per cent foreign equity investment was encouraged in large part to create rapid growth and mass employment opportunities for Malay rural migrants to the urban industrial sector that is a goal of the NEP.

Accordingly, the industrial coordination Act 1975, requires all manufacturing establishments employing more than 25 people to obtain

licenses and confirm to the NEP. The government has encouraged FDI mainly in offshore locations, following the Free Trade Zones (FTZs) Act of 1971. The export oriented industries are allowed 100 per cent ownership and firms granted "pioneer status" were exempted from corporate tax and a development tax depending on various criteria such as capital invested, Jobs created, location in a new development area, high (50 per cent) local material content, export orientation etc. Non-tax incentives includes subsidized industrial estates, FTZs, licensed manufacturing warehouses, tariffs protection for import substituting firms, other import restrictions and investment guarantee agreements. There is no restrictions on repatriation of capital dividends, royalties and technical and service fees though technology transfers agreements must have the approval of the Ministry of Trade and Industry to ensure that they will not harm the local party or additional interest and that fees are reasonable. Most sectors are open to foreign investors with the exceptions including postal services, telecommunications and public utilities. The promotion of Investment Act 1986 provides incentives for manufacturing, agriculture, tourism and hotel projects, research and development, technical or vocational training and multimedia.

A foreign investment committee monitors compliance with guidelines on mergers and acquisitions according to foreign investment committee guidelines 1974. The recession of 1985-86, larger government budget and balance of payments deficits, declining external borrowings and domestic and foreign investment, led to more generous and flexible investment incentives and more promotion of foreign investment. The promotion of investment Act 1986 provides for exemption from the income and development tax for companies engaged in manufacturing new products or undertaking modernization expansion and /or

diversification. The 1986, foreign equity rules allow negotiation and flexibility in implementing the NEP rules and restructure them so that 70 per cent of the equity is held by the Malaysian interests. The 30 per cent minimum equity share for Malay community has been waived for new investment taking place between October 1986-1990, which can be fully foreign owned, if the company exports more than half of its production or employs 350 or more fulltime Malaysians. Further, a foreign company can get up to 100 per cent of its capital expenditure as an investment allowance. In addition to the exporting 50 per cent of its production, it satisfies certain conditions relating to value added, local employment and location. The Malaysian Industrial Development Authority (MIDA) helps foreign investors to find local partners. The other incentives include a reinvestment allowance deductions for local research and development and an incentive for manpower training. A new investment fund was set up in 1985 to finance new fixed investments in manufacturing and agriculture, tourism and mining with the objective of increasing domestic advantages (relatively low labour costs but good infrastructure and skills and abundant resources) has stimulated a large increase in foreign investment inflows in 1988. Foreign investors were allowed to hold 100 per cent equity irrespective of the level of exports in new investment expansion or diversification of manufacturing projects with the exception of specific activities and products where Malaysian small and medium scale companies have capabilities and expertise.

In late 1980, further liberalization of policies on foreign investment and the provision of attractive investments incentives with increasing production costs in Japan and the newly industrialized Asian economies was a major driving force for increasing foreign direct investment flows in the manufacturing sector. Although, Malaysia has

taken major industrialization programme since 1982, but the industrial master plan up to the year 2000 was released in 1986. Its primary objective was to deviate from the period of heavy industrialization embarked upon the early 1980s by laying emphasis on commodities and the extractive industries for future investments .In doing so, various initiatives have been taken to stimulate private sector investment.[38]

In 1988-89, there has been a cut in the corporate tax rate from 40 per cent to 35 per cent, gradual abolition of the 5 per cent development tax starting with a one per cent cut in 1990 accelerated depreciation for the petroleum sector and tax breaks for multinationals setting up their regional operational headquarters in Malaysia. In addition, established companies of which continue to invest in Malaysia may as of January 1989, qualify for tax free "pioneer status" (previously awarded only to new investors) or investment tax allowance, subject to certain conditions.[39]

In 1990, investment and industrial polices were geared towards encouraging value added and capital and technology intensive industries. The projects, embodying high technology, high value added, higher level skill requirements, strengthening of industrial linkages and having greater export potential are being promoted. All the existing companies with export requirements are allowed to get approval from the Ministry of International Trade and Industry (MITI) to sell up to 50 per cent of their output in domestic market. In telecommunications 61 per cent of foreign ownership is allowed which would be reduced to 49 per cent after 5 years. The shipping companies are allowed 70 per cent foreign equity whereas forwarding agencies and insurance companies are allowed 49 per cent and 51 per cent foreign equity respectively. The corporate income tax is 28 per cent. In the case of a company carrying petroleum

production, the applicable tax rate is 10 per cent. A non-resident is subject to personal income tax rate of 29 per cent without any personal relief. In order to promote certain investments e.g. strategic projects, high technology industries, R&D activities and multimedia industries. Investment Tax Allowance (ITA) of up to 100 per cent was allowed to offset against 70 per cent or up to 100 per cent of statutory income. A larger qualifying period of 10 years can also be considered. As an added incentive, companies located in the states of Sabah and Sarawak in east Malaysia and the "eastern corridor" of peninsular Malaysia will be granted an allowance of 80 per cent in respect of the qualifying capital expenditure incurred. The allowance can be utilized to offset against 85 per cent of statutory income in the year of assessment. Libuan, a federal territory of Malaysia was established in October 1990, as an International Offshore Financial Center (IOFC) to provide for the development of offshore activities in the areas of offshore banking and insurance, offshore investment holding and licensing companies and other offshore activities required by the multinational companies. All payments in foreign currency to non-residents for the repatriation of capital, profits, dividends, interests, rental and commissions are freely permitted.

The patent Act 1983, was amended in 1993, which provides that the period for patent protection up to 15 years from the date of granting a patent. Similarly, the Trade Marks Act of 1976 were amended in 1993, which is modeled along the acts of some developed countries, providing effective and adequate protection for registered trade marks. An ITA of 60 per cent (80 per cent in the Eastern corridor of Peninsular Malaysia, Sabah and Sarawak) is available to approved companies for qualifying capital expenditure incurred within five years of the date of approval of the allowance. The ITA can set off against 70 per cent (85 per cent in

eastern corridor of Peninsular Malaysia in Sabah and Sarawak) of statutory income in the year of assessment. The rate is 100 per cent for qualifying capital expenditure for an activity or a product of a national and strategic importance. Similarly the rate is 100 per cent for a R&D company or a technical or a vocational training company. A company conducting in house research is eligible for an ITA is having 50 per cent rate, for a high-tech company the rate is 60 per cent and for a company located in a promoted area, the rate is 80 per cent. Any used portion of the ITA can be carried forward to future years of deduction. The companies that set up operational headquarters in Malaysia enjoy a concessionary 10 per cent tax rate for 5 to 10 years on income arising from the provision of qualifying services to their offices or related companies outside Malaysia. Approved Service Projects (APS) are projects related to transportation, communication, utilities or any other sub-sector approved by the Ministry of Finance. The main tax incentives available to an ASP either on income tax exemption of 70 to100 per cent statutory income for 5 to 10 years or on investment allowances equivalent to 60 to 100 per cent of qualifying capital expenditure incurred within five years from the date of approval as an ASP. The investment allowance can be set off against 70 to 100 per cent of the statutory income.

The foreign fund management companies are subject to reduced rate of 70 per cent of their chargeable income derived from providing fund management services to foreign investors. This chargeable income after the deduction of 10 per cent tax forms the exempt account of the company from which tax free dividends can be declared on a two tier basis. The national rate of corporate tax come to 28 per cent and the income tax rate for the petroleum operation is 38 per cent. MIDA,

provides various incentive schemes to investors according to the relevance of the project. The export oriented firms are accorded the same facilities irrespective of whether investment are made by foreign or local investor with a view to enhance greater integration between the secondary sector and domestic sales, certain export-oriented firms have been allowed to sell up to 50 per cent of their output locally during the period stretching from early 1998, to the end of 2000. Apart from export oriented high technology industries, the multimedia sector and certain priority areas, the limit of 30 per cent of foreign share holding has been raised to 49 per cent, for telecommunications to 51 per cent for existing insurance companies and to majority or fully foreign owned for fund management companies.

5.2 Trends in FDI Flows

Foreign direct investment has played a significant role in the growth and development of the country and it has transferred Malaysia, from basically primary producer to an industrialized economy. After the inception of its independence in 1957, Malaysia has gone along the cautious promotion strategy towards liberalized policy framework. As a result of these policy measures foreign direct investment has increased from US $570 million in 1974 to US $1260.5 million in 1983 and further to US $5183.4 million in 1992 (Table 3.11).

After 1992, foreign direct investment flows has decreased except for the year 1996, when it reached its peak of US $7296 million and thereafter it declined to US $554.0 million in the year 2001. The overall FDI flows scenario is not good and there has been a large differences between the approvals and actuals.

Table 3.11
Foreign Direct Investment in Malaysia: Approvals vs Actuals During 1990-2001

(US $Millions)

Year	Approvals	Actuals	% Growths (Actuals)
1990	6517.5	2332.5	39.9
1991	6201.7	3998.5	71.4
1992	6976.6	5183.4	29.6
1993	2442.5	5006.6	3.4
1994	4320.8	4342.8	-13.3
1995	3651.0	4132.0	-4.9
1996	6779.5	7296.0	76.6
1997	4078.2	6324.0	-13.3
1998	3330.4	214.0	-57.1
1999	3230.0	3895.0	43.5
2000	5215.6	3788.0	-2.8
2001	4827.2	554.0	-85.4

Source: World Investment Directory and World Investment Report (Various issues).

Country-Wise Break-Up of FDI Flows

Table 3.12(a), presents the country-wise break-up of foreign direct investment, which reveals the fluctuating trend over the years. The important feature is that the share of leading countries has been decreased in 2001 as compared to 1987. In the year 1987, the top five investing countries in Malaysia were Japan, Singapore, Taiwan, USA and Australia and together they accounted for 73 per cent of the total foreign direct investment flows, whereas in the year 2001, the top five contributors were USA, Japan, China (Hong-Kong), Singapore and Netherlands and together they accounted for the 76 per cent of the total foreign direct investment flows.

Table 3.12(a)
Country - Wise Break - Up of Foreign Direct Investment in Malaysia During 1990-2001

(US $Million)

Country/ Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
Japan	1557.5	527.6	1053.6	645.3	672.6	836.9	1830.7	356.5	551.4	264.7	758.2	864.9	9919.9
Singapore	330.9	144.7	173.5	202.8	405.4	402.9	1894.4	320.6	326.4	237.4	467.9	573.8	5480.7
USA	209.6	165.5	1295.1	683.0	477.5	719.5	1059.7	1833.9	610.8	1357.6	1971.6	869.8	11253.6
Hong Kong	138.6	114.5	31.0	36.5	333.0	69.9	5.6	22.4	5.9	16.6	90.8	0.0	864.8
United Kingdom	320.5	68.5	511.9	17.1	35.8	75.9	146.3	68.3	52.8	50.5	203.2	26.7	1577.0
Republic of Korea	240.3	169.5	38.9	43.1	155.9	241.7	256.0	12.4	172.8	9.2	190.3	446.4	1976.5
Australia	20.0	64.0	834.6	20.2	67.1	55.9	54.5	18.5	23.2	13.7	34.2	15.5	1221.4
Germany	47.0	20.7	28.7	25.3	249.6	59.9	58.8	66.5	461.5	49.2	435.8	127.1	1630.1
Taiwan	2343.5	584.0	588.8	347.3	1095.2	575.8	308.4	94.9	342.7	70.3	241.1	292.8	6884.8
Canada	30.6	23.1	8.8	2.8	3.3	20.0	18.8	5.9	10.6	30.2	1.5	13.4	169.0
Others	1279.0	326.7	2411.7	419.1	825.4	592.6	1146.3	1278.3	770.8	1130.6	828.6	1596.8	12605.9
Total	**6517.5**	**2208.3**	**6976.6**	**2442.5**	**4320.8**	**3651.0**	**6779.5**	**4078.2**	**3328.9**	**3230.0**	**5223.2**	**4827.2**	**53583.7**

Source : World Investment Directory and World Investment Report (Various issues).

Note : Data on FDI are on Approval basis and Includes only Secondary sector and has been transferred from the exchange rates taken from the international Financial Statistics (Year book), IMF, 2003.

The flows of foreign direct investment from the USA has been increased from US $64.6 million that is 7.9 per cent of the total foreign direct investment flows in the year 1987 to a peak of US $1971.6 million that is 37.8 per cent of the total foreign direct investment flows in year 2000 and has declined to US $869.8 million that it becomes 18 per cent of the total foreign direct investment flows in the year 2001. This has been followed by Netherlands whose share has been increased from US $15 million that is only from 0.2 per cent of the total foreign direct investment flows in the year 1990 to US $571.8 million that is 11.9 per cent in the year 2001. This has been followed by Singapore whose share has been increased from US $331.0 million that is 5 per cent of the total foreign direct investment flows in the year 1990 to a peak of US $1894.2 million that is 28 per cent in 1996 and to US $8573.8 million that is 11.9 per cent in the year 2001. Similarly, the share of Germany was 2.6 per cent, Switzerland 0.5 per cent in the total of foreign direct investment flows in the year 2001. The share of Taiwan has been decreased from US $234.6 million that is 36 per cent in 1990 to US $292.8 million that is 6.1 per cent in the year 2001. Similarly the share of Japan has been decreased from US $1557.4 million that is 23.9 per cent in 1990 to US $864.9 million that is 17.9 per cent in the year 2001. Similarly, the share of United Kingdom and Indonesia has come down from 4.9 per cent and 6.1 per cent in 1990 to 0.6 per cent and 0.3 per cent respectively in the year 2001.

Country-Wise Break-Up of FDI With Selected Statistical Values

Table 3.12(b), depicts the country-wise break-up of foreign direct investment in Malaysia showing that there is a fluctuating trends during the period 1990 – 2001. The country-wise flows of foreign direct

Table 3.12(b)
Country - Wise Break - Up of Foreign Direct Investment in Malaysia With Selected Statistical Values

Country	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression. Coefficient	R-Squared	CRG (%) Per Year
Japan	264.70	1830.70	826.66	463.06	56.12	Ln (JP)	6.91627 (20.62791)	-.05169 (1.13472)	.114	5.30
Singapore	144.70	1894.40	456.73	469.80	102.86	Ln (Sing)	5.35949 (13.58375)	.07704 (1.43722)	.171	8.01
USA	165.50	1971.60	937.80	584.13	62.29	Ln (USA)	5.65519 (15.34718)	.14736 (2.94344)	.462	15.88
Hong Kong	0.00	333.00	72.07	93.98	130.41	Ln (HK)	4.78277 (6.09695)	-.18071 (1.56242)	.213	19.81
United Kingdom	17.10	511.90	131.46	148.58	113.02	Ln (UK)	4.97014 (8.02288)	-.08927 (1.06062)	.101	9.34
Republic of Korea	9.20	446.40	164.71	127.26	77.26	Ln (RK)	4.67771 (5.74643)	-.00990 (.08953)	.001	0.99
Australia	13.70	834.60	101.78	231.64	227.58	Ln (Aust.)	4.59068 (7.11896)	-.141128 (1.61256)	.206	15.17
Germany	20.70	461.50	135.84	158.95	117.01	Ln (Ger)	3.16162 (5.91884)	.18416 (2.53747)	.391	20.22
Taiwan	70.30	2343.50	573.73	621.71	108.36	Ln (Taiw)	7.15907 (16.38777)	-.18792 (3.16605)	.501	20.67
Canada	1.50	30.60	14.08	10.36	73.56	Ln (Can)	2.66616 (4.24939)	-.05847 (.68590)	.045	6.02
Total (Inclusive others)	2208.30	6976.60	4465 31	1635.29	36.62	Ln (TT)	8.31582 (33.81994)	.00366 (0.10974)	.001	11.60

Note : Figures in Parenthesis show t – values.

investment together with the compound rate of growth and other values can be had from the Table 3.12(b), during the period 1990 – 2001.

It can be observed form the Table 3.12(b), that the compound rate of growth of foreign direct investment during the period 1990 – 2001 was 11.60 per cent per annum. The top five countries which contributed in the highest compound rate of growth was from Taiwan with 20.7 per cent, Germany with 20.2 per cent, Hong-Kong with 19.8 per cent, USA with 15.9 per cent and Australia with 15.2 per cent per annum.

The top five countries in foreign direct investments were USA, Japan, Taiwan, Singapore and Republic of Korea and together they accounted for 66.3 per cent Table 3.12(b) of the foreign direct investment flows had a coefficient of variation (at 62.29 per cent, 56.12 per cent, 108.36 per cent, 102.86 per cent and 77.26 per cent respectively) during the period 1990 – 2001. But the average compound rate of growth for the same countries was merely 10.17 per cent during the same period. The highest coefficient of variation among the top ten countries has been found to be with the Australia by 227.6 per cent showing less consistency whereas the lowest variation or the strong stability is found with Japan with 56.11 per cent coefficient of variation during the period 1990 – 2001.

Sector-Wise Break-Up of FDI Flows

The sector-wise break up of foreign direct investment as presented in Table 3.13(a), shows the fluctuating trend over the years. The top five sectors which got largest share of foreign direct investment during 1987, was electrical machinery and apparatus, chemicals and chemical products, rubber and plastic products, food beverages and wood and together they constitute 86.4 per cent of the total foreign direct investment flows in the year 1987. The top five sectors have attracted the

Table 3.13(a)
Sector – Wise Break – Up of Foreign Direct Investment in Malaysia During 1990-2001

(US $Million)

Sector/Years	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
Electronics and Electrical Products	1394 9	414 5	375 7	711 3	1838 6	947 9	3672 7	1022 0	485 7	1564 7	2686 8	2478 9	17593 7
Paper, Printing, Publishing	138 3	30 9	12 6	47 8	32 4	39 1	624 8	168 9	73 1	281 8	55 8	811 6	2317 1
Non-metallic Mineral Products	66 6	265 8	131 1	44 7	306 8	501 1	258 4	41 2	118 5	70 3	402 1	419 8	2626 4
Chemicals and Chemical Products	638 5	246 2	518 6	684 9	428 3	729 1	835 1	259 5	1057 5	69 2	154 5	162 9	5784 3
Food Manufacturing	120 5	39 6	84 4	71 9	78 0	47 5	50 9	61 9	93 0	72 9	142 1	134 3	997 0
Basic Metal Products	1678 1	313 1	304 2	305 7	149 4	189 7	243 3	248 9	137 9	62 6	112 6	109 3	3854 8
Machinery Manufacturing	431 8	34 9	150 7	22 5	97 9	92 6	134 0	163 9	38 7	59 5	110 5	91 1	1428 1
Fabricated Metal Product	112 8	302 9	40 0	37 3	93 7	113 8	229 7	215 1	252 8	43 4	42 9	91 0	1575 4
Transport Equipment	103 2	38 2	30 6	123 1	94 9	184 1	132 4	99 9	128 2	60 8	71 8	129 3	1196 5
Rubber Products	20 0	32 4	19 2	14 8	22 9	28 0	22 7	32 0	12 5	8 4	175 8	59 1	447 8
Others	1812 8	489 8	5309 5	378 5	1177 9	778 1	575 5	1764 9	931 0	936 4	1268 3	339 9	15762 6
Total	**6517.5**	**2208.3**	**6976.6**	**2442.5**	**4320.8**	**3651.0**	**6779.5**	**4078.2**	**3328.9**	**3230.0**	**5223.2**	**4827.2**	**53583.7**

Source World Investment Directory and World Investment Report (Various issues)

Note Data on FDI are on Approval basis and Includes only Secondary sector and has been transferred from the exchange rates taken from the international Financial Statistics (year book), IMF, 2003.

largest amount of foreign direct investment which includes electronics and electrical products, paper printing and publishing, non-metallic mineral products chemical and chemical products, scientific measurement and together they constitute the 83.2 per cent in the year 2001.

The flows of foreign direct investment in the electrical machinery and apparatus has been increased from US $298.6 million that is 36.5 per cent in 1987 to US $3672.4 million that is 54.2 per cent in 1996 and further to US $2479 million that is 51.4 per cent in 2001. Similarly, the share of the rubber and plastic product has been increased from US $117.3 million that is 14.3 per cent in 1987 to US $870.7 million that is 18 per cent in the year 2001. Similarly, the share of the non-metallic mineral products has been increased from US $31.6 million that is 3.9 per cent in 1987 to US $419.6 million that is 8.7 per cent in 2001 to the total foreign direct investment flows. Similarly, the share of coke, petroleum products and nuclear fuel has been increased from US $82.6 million that is 2.6 per cent in 1989 to a peak of US $603.9 million that is 66 per cent in 1992 to US $ 304.0 million that is 6.3 per cent in the year 2001. The share of the basic metals and metal products has been increased from US $36.1 million that is 4.4 per cent in 1987 to a peak of US $1831.3 million that is 29.5 per cent to US $109.3 million that is 2.3 per cent of the total foreign direct investment flows in the year 2001. Similarly, the share of chemical and chemical products has been increased from US $129.3 million that is 15.8 per cent in 1987 to a peak of US $684.7 million that is 28 per cent in 1993 to US $163.0 million that is only 3.4 per cent of the total foreign direct investment flows in the year 2001.

Sector-Wise Break-Up of FDI With Selected Statistical Values

In the preceding table we have seen the sector-wise break-up of foreign direct investment in Malaysia during 1990 – 2001. The sector

Table 3.13 (b)

Sector - Wise Break - Up of Foreign Direct Investment in Malaysia With Selected Statistical Values

Sectors	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per Year
Electronics and Electrical Products	375 70	3672 70	1466 14	1037 04	70 73	Ln (EEP)	6 34337 (15 08560)	10775 (1 88602)	262	11 34
Paper, Printing and Publishing	12 60	811 60	193 09	259 92	134 61	Ln (PPP)	3 22898 (4 72401)	19715 (2 12283)	311	21 79
Non-metallic Mineral Products	41 20	501 10	218 87	162 38	74 19	Ln (NMP)	4 65681 (8 21708)	06225 (80847)	061	6 42
Chemicals and Chemical Products	69 20	1057 50	482 03	312 09	64 75	Ln (CH)	6 65708 (14 29224)	- 11368 (1 79632)	244	12 04
Food, Manufacturing	39 60	142 10	83 08	33 71	40 58	Ln (FM)	4 06416 (16 68608)	04310 (1 30258)	145	4 40
Basic Metal Products	62 60	1678 10	321 23	435 76	135 65	Ln (BMP)	6 55660 (21 02966)	- 18362 (4 33450)	653	20 16
Machinery Manufacturing	22 50	431 80	119 01	108 48	91 16	LN (MM)	4 68072 (9 18041)	- 03014 (43513)	019	3 06
Fabricated Metal Product	27 30	302 90	131 28	94 06	71 64	Ln (FMP)	4 7626 (9 56519)	- 02314 (0 34173)	012	2 34
Transport Equipment	30 60	184 10	99 71	44 02	44 15	Ln (TE)	4 19378 (12 75335)	04543 (1 01678)	094	4 65
Rubber Products	8 40	175 80	37 32	45 53	122 00	Ln (RP)	2 77231 (5 83641)	07448 (1 15404)	118	7 73
Total (inclusive Others)	2208 30	6976 60	4465 31	1635 29	36 62	Ln (TT)	8 31582 (33 81994)	00366 (10974)	001	11 60

Note Figures in Parenthesis show t – values

wise break up of foreign direct investment together with the compound rate of growth can be had from the Table 3.13(b), during the period 1990 – 2001. The Table 3.13(b), depicts that the compound rate of growth of foreign direct investment during the period 1990 – 2001 was 11.60 per cent per annum. It can be stated from the Table 3.13(b), that the highest compound rate of growth of foreign direct investment inflows among the top five sectors includes the paper, printing and publishing with 21.8 per cent, basic metal products with 20.2 per cent, chemical with 12.0 per cent, electronics and electrical product with 11.3 per cent and rubber products with 7.7 per cent during the period 1990 – 2001. The top five sectors which have attracted the bulk of foreign direct investment includes electronics, chemicals, basic metal products, non-metallic mineral products, paper printing and publishing and together they accounted for 60.1 per cent (Table 3.13(a)) had a coefficient of variation (at 11.34 per cent, 12.04 per cent, 20.16 per cent, 6.42 per cent, 21.79 per cent respectively during the period 1990 – 2001. But the average compound rate of growth for the above sectors is merely 14.35 per cent. The highest variation among the top ten sectors has been found to be with the basic metal products with 135.7 per cent variation whereas the food industry is having the strong consistency in foreign direct investment flows during the period 1990 – 2001.

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CHAPTER-4

Chapter – 4

FOREIGN DIRECT INVESTMENT IN INDIA

4.1 INTRODUCTION

India has a long history of foreign firms participating in its economy. It had once become one of the third world largest reservoir of foreign investment. The country is endowed with rich natural resources including minerals, forest, vast agricultural land and a large pool of manpower. It is also one of the largest reservoir of the technical and skilled manpower in the world. Soon after independence, India embarked on a strategy of import substituting industrilisation in the framework of development planning with a focus on development of local capability in heavy industries including the machinery and manufacturing sector.

Along with domestic high tariffs and quantitative restrictions on imports, foreign direct investment was sought on mutually advantageous terms through the majority local ownership. There was an increasing recognition of foreign capital as an important means to supplement domestic savings for the development of the country and for securing scientific, technical and industrial know-how etc. Foreign investors were assured of no restrictions on the remittance of profits and dividends, fair compensation in the wake of acquisition, and of a national treatment.

Over the period of time, the developing countries started encouraging these investments with the hope of reaping the benefits of capital inflows that is employment, workers training and technology transfers etc. Moreover, the MNCs in the NIEs have been provided better prospects and profits as compared to the already started economies. The newly industrialized economies like China, Singapore, Malaysia and Hong-Kong etc. have attracted larger amount of foreign direct investment.

The increasing attraction of India to foreign companies arises from relatively good prospects at a time when the world economies were not doing well. Foreign investers have been attracted by a variety of factors including political stability in a democratic polity, an economy characterised by steady growth and a single digit inflation rate, vast army of trained manpower, a strong entrepreneurial class, a fairly well developed social system and physical infrastructure, a vibrant financial system including a rapidly expanding capital market and a diversified industrial base. In general, private overseas capital is not given much emphasis as a source of financial flows to augment national savings and in particular foreign investment is not regarded as a major factor in overall economic growth, though it is now recognized as important in certain sectors and acquisition of technology and increasing exports.

It has been emphasized that Indian capital needs to be supplemented by foreign capital not only because national savings are not sufficient for the rapid development of the country, but also in many cases scientific, technical and industrial knowledge and capital equipment is best secured along with foreign capital. Foreign capital, therefore, was intended to supplement domestic savings while the focus was on acquiring improved technology from abroad and less on foreign direct investment. Foreign direct investment has not come in the country in the desired amount because foreign direct investment policy was on technology transfer and not on investment. As expected foreign direct investment has played a supplementary and subsidiary role since it was used as a vehicle for technology transfer. As a result of the past polices foreign investments are not attracted in the desired manner. Moreover, after independence, government has adopted wrong policies and rely heavily on foreign aid including, Official Development Assistance

(ODA) and concessional loans which resulted in high debt servicing, Balance of Payment (BOP) problems which were not conducive for the faster growth of foreign direct investment.

However since 1980, the general economic framework and investment climate have improved. India started liberalizing fully her economy by mid 1991 when there was a keen competition for foreign direct investment on the global level. The industrial policy resolution of 1991 have provided a fairly liberalized policy framework to attract foreign direct investment in India which were coupled with those in several other Asian countries. The trade and foreign direct investment polices have become the focus of liberalization and get a top priority in the India's agenda of development strategy. There were numerous incentives including industrial estates, Export Promotion Zones (EPZs), export processing units and more recently developed technology parks have attracted considerable attention. In addition, a broad spectrum of financial incentives in the form of tax holidays, business services are offered by central and other state authorities to encourage economic development. The 1990s have clearly seen a radical change in India's policy towards foreign investment, which is now actively engaged in all sectors. So, the industrial policy resolution of 1948 and 1956 as well as Nehru's statement on foreign capital constitute the basis of the government policy on foreign capital till 1991.

In sum, the government of India's policy toward foreign direct investment or foreign collaborations has evolved from caution promotions in the late 1940s to a brief period of near "open door" Policy in the 1950s to a policy of rigorous selectivity in the late 1960s and 1970s and further to a policy of increasing liberalization in the 1980s and 1990s. These policy swings have reflected the broader economic development

priorities and objectives of the government embedded in a political culture that has favoured incremental rather than radical advances.

4.2 FDI FLOWS IN PRE-REFORM PERIOD

4.2.1. Policy Framework

At the time of independence, the attitude towards foreign capital was one of the fears and suspicious due to the previous exploitative role played in draining away resources from the country. The legal and institutional framework governing FDI in India consists of a complex labyrinth of legislative enactment and policy directions designed primarily for the regulation of domestic investment. The government exercises virtually complete discretion in interpreting and applying these legal and policy provisions to shape and control FDI in the pursuance of its policy goals. The indoor government policy towards FDI before economic reform may be divided into three distinct phases. Though these are not exactly separable, it is convenient to look at three phases.

The Phase of Cautious Promotions: 1948 – 67

After independence, India adopted highly protective approach towards foreign capital though it was too ambitious towards the import of foreign capital. The industrial policy resolution of 1948 acknowledged the need for foreign capital to supplement the domestic saving in financing higher levels of investment. However, it advocated an effective Indian control over the management of such foreign capital to ensure its regulation in the national interests.[1] The suspicious hostility found expresses in the industrial policy of 1948, which although recognizes the role of private foreign investment in the county emphasized that its regulation was necessary for national concerns. The aforesaid attitude resulted in obstruction of capital imports. In 1949, P.M

Nehru emphasizes the necessity of foreign investment to parliament that foreign investment is necessary to supplement domestic capital but also to secure scientific, technical and industrial knowledge and capital equipment. Furthermore, P.M Nehru has made a statement in April 1949 giving three important assurances to foreign investors.

(a) India would not make any discrimination between foreign and local investors

(b) Foreign exchange, permitting reasonable facilities would be given to foreign investors for remittance of profits and repatriation of capital and

(c) In case of nationalization of undertaking, fair and equitable compensation would be paid to foreign investors.

Though restrictions on FDI were relaxed, but majority ownership and control was preferred in local hands except those industries using highly sophisticated technology and for export – oriented units. A crisis in financial resource mobilization for the second five year plan (1956-61) has further liberalized its stance towards FDI. In a bid to attract foreign investment to finance foreign exchange component of projects a host of incentives and concessions were introduced. The protection accordingly as an import location advantage encourages market - seeking FDI.

The foreign exchange crisis of 1957–58 led to a further liberalization of the government stance towards foreign capital. For instance the Indo – US convertibility agreement was signed in April 1957. In the same year a number of tax concessions were made to foreign firms which affected salaries, wealth tax and super tax, corporate taxes or income and royalties were reduced in the 1959 and 1961 budgets.

In 1961, foreign investments were welcomed in those industries, which were earlier reserved for the public sector such as drugs,

aluminum, heavy electrical equipments, fertilizers and synthetic rubber etc. It was clearly stated that foreign investment that cover the foreign exchange cost of plant and machinery in approved projects would be welcomed.

Infact, proposals involving foreign financial collaborations enjoyed a premium in government approvals during those years (Kidron, 1965). The government also assured to treat equally foreign firms at par with domestic firms. By a declaration issued on June 2, 1950, the government assured the foreign capitalists that they could remit the profits on foreign investment made by them in the country.[2] The policy statement of P.M issued on 1949 continued till 1956 industrial policy resolution, which had opened up immense fields for foreign participation. The government failure to control TNCs especially the large oil companies who imported crude oil from the parent companies and shipped it in there own tankers has led to the formation of the ONGC and the IOC in 1959 primarily with the objective of reducing the monopoly stronghold of the oil companies (Martinuseen, 1988). This policy of state intervention also confronted to 'commanding heights' of the objective of the 1950 industrial policy resolution.

The new industrial policy resolution of April 1956 was drawn up in accordance with the goal of a "socialistic pattern" of society adopted by the parliament in 1954. The resolution embarked a number of important industries for the public sector, thus reducing the scope of operation of the private local as well as foreign sector. However, the resolution did not make any further distinction within the private sector or between domestic and foreign enterprises. In 1957, and afterwards the problem of foreign exchange drain has however resulted in substantial flowing of foreign investment into even non-essential items.

The Restrictive Phase: 1968 – 1979

In the late 1960's the effects of foreign economic domination and foreign exchange drain have brought the tightening of the restrictions for FDI regime. The liberalization of the policy towards foreign capital till mid-1960's have resulted in the outflows on account of remittance of dividends, profits, royalties and technical fees grew sharply and become a significant proportion of the foreign exchange account of the country. This has resulted in foreign exchange crisis in the late 1960s and has led to the streamlining of procedures for foreign collaboration approvals and the adoption of a restrictive attitude.

In 1968, on the recommendations of the Mudaliar committee on foreign collaborations 1966, Foreign Investment Board (FIB) was set-up to deal with the case of foreign investments and collaborations with a maximum limit of 40 per cent of the paid up equity capital of the company and up to Rs. 20 million share capital. The cases exceeding this limit were considered special and referred to the cabinet committee. This has strengthened the restrictions of foreign participation to 40 per cent and marked the beginning of the restricting Phase for FDI regime.

A sub – committee of the FIB was empowered to approve cases involving foreign collaborations in which the proportion of foreign equity held did not exceed 25 per cent with an upper limit of Rs. 10 million. The administrative ministries were authorized to approve cases involving purely technical collaborations. Foreign Investors unaccompanied by technology were not permitted.[3]

In later case, a permissible range of royalty payments was also specified for different items, which generally did not exceed 5 per cent. The permitted duration for the foreign collaborations was reduced from 10 to 5 years and their renewals were restricted. Respective clauses

concerning the sub – licensing of technology in the country and exports (except to those counties where the technology supplier already had affiliates) were opt to be permitted (Government India, Ministry of Industry, 1982). Further a list was issued which divided industries into three categories (i) where foreign collaborations was not considered necessary (ii) where only technical collaboration was to be allowed and (iii) where FDI might be allowed.[4]

The permission was subject to the Indianisation or dilution of their foreign equity as per government guidelines for implementation of the Act issued in 1973 and amended in 1976. These guidelines required foreign branches to transfer all their businesses to Indian companies that had up to 40 per cent foreign equity.

The FERA was passed in 1973 to regulate the FDI activities, which directly or indirectly affect India's foreign exchange reserves. It required all foreign companies operating in India to register under Indian corporate legislation up to 40 per cent foreign equity. Exceptions from the general limit of 40 per cent were made only for companies operating in high priority or high technology sectors, tea plantations or those predominantly for exports.[5] In coming years, FERA become the central piece of legislation, guiding and controlling FDI in India. The new Industrial policy issued in 1973 specified the areas in which non – FERA companies could operate. It has specified a detailed list of industries in which foreign firms could participate with or without FDI that is only in technical collaborations. Except for the intermediate and consumer goods, the policy statement allowed up to 49 per cent foreign equity in high technology and priority sectors, which usually involves large Investments.

Under FERA, foreign enterprises have to divest their foreign shareholding to 40 per cent and convert to Indian companies under the companies Act of 1956. However, the companies operating in the core sector, tea plantations and those engaged in manufacturing activities based on sophisticated technology or predominantly producing for exports were permitted to retain up to 51 or 74 per cent foreign equity. All other companies incorporated in India with foreign equity up to 40 per cent were allowed to expand, diversify and operate in any field like any local company. An assurance to this effect was made in the industrial policy statement of 1977.[6]

The companies under FERA were able to operate, expand and diversify in any industry, which are open to other local private firms. Thus, for most foreign companies FERA provided an opportunity to become Indian and to expand.

The restrictions were put on proposals of FDI unaccompanied by technology transfer and are those seeking more than 40 per cent foreign ownership. The government listed industries in which FDI was not considered desirable in view of the local capabilities.

Investment made in machinery, fabrication facilities, manpower development, scientific and technological infrastructure made in the pervious period led to the development of certain created assets in the country. The outflow on account of remittance of dividends, profits, royalties and technical fees etc abroad on account of servicing of FDI, technology and the imports from the earlier period which had grown sharply and had become a significant proportion of the foreign exchange account of the country. All these factors together prompted the government to streamline the procedures for foreign collaboration approval and adopt a more restrictive attitude towards FDI.[7]

During 1970s, regulatory regime was further tightened, as reflected in the industrial policy statement of 1977, which prohibited foreign collaborations in certain industries on the ground that indigenous technology in these industries had sufficiently developed. These industries include metallurgical industries, miscellaneous mechanical and engineering industries, rubber industries, chemicals (other than fertilizers), drugs and pharmaceuticals etc.

As a result, the number of foreign branches came down from 500 in 1974 to about 300 in 1988.[8] Several sectors of the industry were closed to foreign firms altogether. In many others, official entry conditions were so cumbersome and restrictive that new foreign capital inflows were effectively excluded. Thus, while achieving very little in the context of existing TNCs, FERA was effective in scaring away potential investors. The period from 1970-80 can then be considered the most restrictive from the point of view of FDI mainly because implementation of FERA was the principal item on the agenda of policy makers. However, in terms of the general attitude towards FDI we can really think of the whole period from 1949 as one of the cautious encouragement followed by strong reaction. The main drawback of the system of control through FERA was that it failed to control the large TNCs for whom it was intended. At the same time it sent negative signals to prospective investors thus perpetuating the monopoly control of foreign and local capital.[9]

The Opening Up of The 1980s

The government attitude towards foreign direct investment becomes liberal during 1980s and particularly since mid 1980s become more so liberal. This shift in official policy occurred in the wake of the second oil crisis and India's failure to boost significantly her manufactured exports. This is more so particularly as a result of the

highly restrictive approach and a heavy curbs on foreign collaborations and imports of technology. The international competitiveness of Indian goods had suffered from growing technological obsolescence and inferior product quality, limited range and high cost, which in turn were due to highly protected local market. Another limiting factor for Indian manufactured exports lies in the fact that marketing channels in the industrialized countries were substantially dominated by multinational enterprises.

In consequence government has come up with a multi pronged strategy to promote exports that is the removal of bottlenecks, facilitating access to import, modernizing machines and equipments and encouraging multinational corporations to undertake export oriented manufacturing. The government intended to deal with the situation by putting emphasis on the modernization of industry with liberalized imports of capital goods and technology, exposing the Indian industry to foreign competition by gradually liberalizing the trade regime and assigning a greater role to the multinational enterprises in the promotion of manufactured exports. The opening up of the economy for foreign investment has been strengthened within the realm of industrial licensing by removing the bureaucratic entanglements and ensuing private enterprise and competition. The recent amendments to the restrictions on large and foreign controlled enterprises under MRTP and FERA signal more liberal investment environment. The objective was countered on the ground that venture would create a competitive environment and would bring new and superior technology. Major amendments of the MRTP Act in 1984 severely curtailed its scope.

Subsequently in 1985, a number of industries have been exempted from licensing agreements, provided they are not subject to FERA or MRTP and is not reserved for the small sector and is not located within

the area of industrial concentration. In order to facilitate diversification of production, providing flexibility to adjust product mix within the overall licensed capacity and to realize the optimum utilization of manufacturing facility, a scheme of broad banding firm in 34 industrial groups was introduced. The procedure for the re-endorsement of the capacity was simplified where modernization, replacement or renovation resulted in the increase of 49 per cent of licensed capacity. Following this, some 25 industries were delicensed in 1985. It was decided that four more Export Processing Zones (EPZs) should be set up in additions to the existing two, one at Kandla (set up in 1965) and another at Santa Cruz (set up in 1972) to attract MNEs to start export oriented units. The import-export policies of these years greatly liberalized the import of raw materials and capital goods by gradually expanding the list of items in the Open General License (OGL).

To facilitate the flow of superior technology to existing industries, the Cabinet Committee on Economic Affairs (CCEA) decided in December 1986, to permit foreign equity participation even in the existing Indian companies employing superior technology. The equity participation under the new policy was however, subject to certain conditions oriented to make sure that this objective was fulfilled.[10]

The procedures for import of inputs were simplified. The corporate income tax and excise duties were rationalized and the area of core industries has been widened. The industrial trade and fiscal policy were rationalized with an ambit to enhance foreign direct investment flows. In 1988, government has taken measures to fast clearance of foreign direct

investment proposals and streamline the remittance process and exempt profits from income tax in particularly export oriented areas for Japanese foreign direct investment.[11] In order to expedite the flow of Japanese Private investment and technology, the government announced the setting of a "fast channel" in May 1988, for their speedy clearance. The government also announced measures to streamline the remittance process and exempted export profits from income tax in order to attract Japanese corporations to produce in India. The fast channel mechanism was subsequently also extended to other major home countries of foreign investors, first to erstwhile West Germany and later to USA, UK and France.[12] As a result of these measures the investment climate in the country gradually improved.

In 1989, a number of measures have been taken which includes the reduction of custom tariffs on general projects, machinery and companies were reduced and decontrolled, and broad banding in respect of industrial licensing was extended to the production of white goods. The Technical Development Fund (TDF) scheme was established in April 1988, and further in March 1989 to allow for import of technology and capital goods up to the foreign exchange equivalent of Rs. 30 million with a provision of further relaxation in deserving cases.[13] The liberalization of industrial and trade policies were accompanied by an increasingly receptive attitude towards

foreign direct investment and foreign collaborations. Approval system was streamlined and a degree of flexibility was introduced in the policy concerning foreign ownership and exceptions from the general licensing of 40 per cent on foreign equity were allowed on the merits of individual investment proposals. The imports of designs, drawings and capital goods were permitted under the liberalization technical development fund scheme. The rules and procedures concerning payment of royalties and lump sum technical fees were reduced. The approvals for opening Liaison offices by foreign companies in India were introduced, thus enabling direct application by a foreign investor even before choosing Indian partner.

In March 1990, government has brought certain measures which includes the abolition of industrial licensing for new units, for fix investments up to Rs.250 million (Rs.750 million for export oriented units) and units located in recognized backward areas.[14] The foreign collaboration was freely allowed provided the royalty payment was restricted to 5 per cent on domestic sales and 8 per cent on exports. Foreign equity investments up to 40 per cent was allowed on an automatic basis provided the landed value of the imported capital goods did not exceed 30 per cent of the value of plant and machines. This measure however could not be implemented. The government was faced with a crisis of severe balance of payments and a rapid rise in external debt coupled with political uncertainty.

4.2.2 Trends in FDI Flows

After independence, the cautious foreign direct investment policy has resulted in a low level of foreign direct investment flows. The amount of foreign direct investment has increased from US$ 79 million in 1980 to US$ 118 million in 1985 and further to US$ 237 million in 1990.

Table 4.1
Foreign Direct Investment in India: Approval vs Actuals During 1980-1990

(US $Million)

Year	Approvals	Actual	% Growth (Actuals)
1980	11.2	79.0	
1981	12.5	92.0	16.5
1982	66.2	72.0	-21.7
1983	61.0	6.0	-91.7
1984	99.4	19.0	-216.7
1985	102.9	106.0	457.9
1986	84.9	118.0	11.3
1987	83.1	212.0	79.7
1988	172.3	91.0	57.1
1989	195.2	252.0	176.9
1990	73.3	237.0	-6.0

Source: India's Investment Center, New Delhi and World Investment Report (Various issues).

The above table asserts that overall foreign direct investment flows scenario was deteriorating and in the year 1990 the annual percentage growth rate of foreign direct investment was even negative by 6 per cent.

Country-Wise Break-Up of FDI Flows

The country-wise break-up of foreign direct investment as in the Table 4.2(a) below, shows that there is almost a fluctuating trend during the period 1981-1990. The important feature is that except Germany almost all the other countries have positive trends in foreign direct investment flows in India. In the year 1981, the top five countries were Germany, USA, UK, Japan and Switzerland and together they account for 86.4 per cent where as in the year 1990, the top five countries were USA, Switzerland, Germany, UK and Italy and together they account for 57.2 per cent of the total foreign direct investment flows.

Foreign direct investment from USA has increased from US $2.6 million that is 20.8 per cent to a peak of US $32.3 million in 1985 and further to US $19.7 million that is 26.9 per cent in the year 1990. This has been followed by Switzerland whose share has been increased from US $0.5 million that is 4 per cent in 1981 to US $7.7 million that is 10.5 per cent in the total foreign direct investment flows in the year 1990. This has been followed by Germany whose share has been increased from US $6.2 million in 1981 that is 49.6 per cent to a peak of US $74.2 million in 1989 and has declined to 5.4 million that it becomes only 7.4 per cent of the total foreign direct investment flows in the year 1990. This has been followed by UK with its share at 7 per cent in 1981 and 5.3 per cent in the total foreign direct investment flows in the year 1990.

Table 4.2(a)

Country-Wise Break-Up of Foreign Direct Investment in India During 1981-1990

(US $Million)

Country / Year	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	Total 1981-1990
USA	2.6	5.3	13.7	7.9	32.3	23.3	22.8	69.8	38.3	19.7	235.7
Germany	6.2	3.7	4.8	2.5	9.6	16.0	7.6	22.3	74.2	5.4	152.3
Japan	0.7	26.5	15.9	5.4	12.7	4.6	5.3	12.5	5.4	2.9	91.9
United Kingdom	0.8	1.7	9.7	1.6	3.0	6.1	6.5	10.0	20.6	5.2	65.2
Italy	0.1	4.2	1.1	0.7	5.6	1.9	2.3	22.0	4.3	3.9	46.1
Switzerland	0.5	1.2	1.1	0.4	0.7	2.6	6.8	1.2	4.8	7.7	27.0
Others	1.6	23.6	14.7	80.9	38.1	30.4	31.8	34.5	47.6	28.5	331.7
Total	**12.5**	**66.2**	**61.0**	**99.4**	**102.0**	**84.9**	**83.1**	**172.3**	**195.2**	**73.3**	**949.9**

Source : India's Investment Centre

Note : Data are on Approvals basis and has been transferred from the exchange rate taken from the International Financial Statistics (Year Book),IMF,2003.

Country-Wise Break-Up of FDI With Selected Statistical Values

We have analyzed the country-wise break-up of foreign direct investment Table 4.2(b) in India which shows that there is an increasing trends in foreign direct investment flows during the period 1981-1990.

The country-wise break-up of foreign direct investment together with the compound rate of growth and other statistical values can be had from the Table 4.2(a), during the period 1981-1990.

It can be observed from the table that the compound rate of growth of foreign direct investment during the period 1981-1990 was 18.47 per cent per annum. It can be said that the top five countries which contributed in the highest compound rate of growth includes USA, Germany, Japan, UK, Italy and together they account for the 62.24 per cent Table 4.2(b), had a coefficient of variation (at 84.41 per cent, 141.84 per cent, 84.64 per cent, 90.73 per cent and 138.10 per cent respectively), during the period 1981-1990. The highest coefficient of variation that is the highest inconsistency has been found to be with the Germany at 141.84 per cent whereas the strong stability is found with the USA having the lowest coefficient of variation at 84.41 per cent among the above mentioned countries.

Table 4.2 (b)
Country - Wise Break - Up of Foreign Direct Investment in India With Selected Statistical Values During 1990-2001

Country	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per Year
USA	2.60	69.80	23.57	19.90	84.41	Ln (USA)	1.35746 (3.16379)	.26099 (3.77437)	.640	29.82
Germany	2.50	74.20	15.23	21.60	141.84	Ln (Ger.)	1.13540 (1.93604)	.18952 (2.00523)	.335	20.87
Japan	.70	26.50	9.19	7.78	84.64	Ln (Jap)	1.85911 (2.49914)	.00374 (.03120)	.0001	0.37
United Kingdom	.80	20.60	6.52	5.92	90.73	Ln (UK)	.16794 (.33726)	.23864 (2.97360)	.525	26.95
Italy	.10	22.00	4.61	6.37	138.10	Ln (Italy)	.88884 (1.11067)	.30668 (2.37784)	.414	35.89
Switzerland	.40	7.70	2.70	2.74	101.37	Ln (Swt.)	.98773 (1.98505)	.27006 (3.36766)	.586	35.89
Total (Inclusive others)	12.50	195.20	94.99	53.32	56.14	Ln (TT)	3.43127 (8.66881)	.16945 (2.65635)	.469	18.47

Note : Figures in Parenthesis show t – values.

Sector-Wise Break-Up of FDI Flows

The sector-wise break-up of foreign direct investment Table 4.3(a) asserts that there is almost a similar pattern in foreign direct investment during the period 1981–1990. The top five sectors which have attracted the bulk of foreign direct investment were industrial machinery, chemicals, mechanical engineering, metallurgy and together they account for the 50 per cent in the year 1981, whereas in the year 1990, the top five sectors were electrical and electronics, chemicals, industrial machinery, mechanical engineering, metallurgy and together they account for the 40 per cent of the total foreign direct investment flows. The individual sector which has attracted the considerable portion of foreign direct investment is electrical and electronics whose share has been increased from US $1 million that is 8 per cent in 1981 to a peak of US $24.4 million in 1989 and further, it has been declined to US $9.8 million that is 13.4 per cent in the year 1990. This sector has been followed by chemicals whose share has been increased from US $1.2 million that is 9.6 per cent in 1981 to a peak of US $31.3 million in 1987 and to US $8.6 million that it has increased to 11.7 per cent in the total foreign direct investment flows during the year 1990. This sector has been followed by industrial machinery with its share at 6.1 per cent, mechanical engineering with its share at 4.9 per cent, metallurgy with its share at 1.8 per cent in the total foreign direct investment flows during the year 1990.

Table 4.3(a)

Sector-Wise Break-Up of Foreign Direct Investment in India During 1981 to 1990

(US $Million)

Sectors / Years	1981	1882	1983	1984	1985	1986	1987	1988	1989	1990	Total 1981-1990
Chemicals	1.2	35.0	0.8	62.4	7.1	23.8	31.3	25.1	57.5	8.6	252.8
Electrical and Electronics	1.0	1.0	7.7	5.0	24.4	23.0	14.2	23.8	24.4	9.8	134.3
Industrial Machinery	2.7	2.1	2.0	4.7	2.7	0.8	6.2	3.1	2.5	4.5	31.3
Mechanical Engineering	1.2	0.6	2.3	4.0	6.8	6.4	1.3	9.0	3.9	3.6	39.1
Metallurgy	0.1	0.3	0.5	2.2	12.0	10.9	1.0	9.5	12.4	1.3	50.2
Miscellaneous	1.2	6.8	27.3	20.4	38.3	19.0	23.3	71.5	68.7	32.5	309.0
Others	5.1	20.4	20.4	0.7	10.7	1.0	5.8	30.3	25.8	13.0	133.2
Total	12.5	66.2	61.0	99.4	102.0	84.9	83.1	172.3	195.2	73.3	949.9

Source : Reserve Bank of India Bulletin (Various issues)

Note : Data are on Approvals basis and has been transferred from the exchange rate taken from the International Financial Statistics (Year Book), IMF, 2003.

Sector-Wise Break-Up of FDI With Selected Statistical Values

The previous table analyses the sector-wise break–up of foreign direct investment in India during 1981 –199, showing the increasing magnitude of foreign direct investment flows.

The sector-wise break-up of foreign direct investment together with other statistical values can be had from the Table 4.3(b), during the period 1981-1990.

Table 4.3(b), depicts that the compound rate of growth of foreign direct investment during the period 1981-1990 was 18.47 per cent per annum. The highest compound rate of growth of foreign direct investment flows among the top five sectors includes metallurgy with 45.08 per cent, electrical and electronics with 36.73 per cent, miscellaneous with 35.72 per cent, chemicals with 25.57 per cent and industrial machinery with 4.73 per cent per annum during the period 1981-1990.

The top five sectors which have attracted the bulk of foreign direct investment were namely miscellaneous, chemicals, electrical and electronics, metallurgy and mechanical engineering and together they account for 82.7 per cent Table 3.4(a), had a coefficient of variation (at 75.67 per cent, 86.83 per cent, 73.66 per cent, 107.62 per cent, 70.44 per cent respectively) during the period 1981-1990. But the average compound rates of growth for the above sectors were merely 32.1 per cent. The highest coefficient of variation among the top five sectors have been found to be with the metallurgy with 107.62 per cent having the higher inconsistency

Table 4.3 (b)
Sector - Wise Break - Up of Foreign Direct Investment With Selected Statistical Values During 1981-1990

Sector	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per Year
Chemicals	.80	62.40	25.28	21.95	86.83	Ln (Ch)	1.31246 (1. 32059)	.22769 (1.42156)	.202	25.57
Electrical and Electronics	1.00	24.40	13.43	9.81	73.66	Ln (EE)	.40745 (.069253)	.31283 (3.29920)	. 576	36. 73
Industrial Machinery	.80	6.20	3.13	1.57	50.29	Ln (IM)	.75810 (1.89716)	.04620 (.71744)	.061	4.73
Mechanical Engineering	.60	9.00	3. 91	2.75	70.44	Ln (ME)	.19723 (.37581)	1.89016	.309	17.34
Metallurgy	.10	12.40	5.02	5.40	107.62	Ln (Meta)	-1.39718 (1.46603)	.37210 (2.42260)	.423	45.08
Miscellaneous	1.20	71.50	30.90	23.38	75.67	Ln (Misc)	1.33434 (2.39806)	.30540 (3.40564)	.592	35.72
Total (Inclusive Other)	12.50	195.20	94.99	53.32	56.14	Ln (TT)	3.43127 (8.66881)	.16945 (2.65635)	.469	18.47

Note : Figure in Parenthesis show t - value

whereas the strong stability is found with industrial machinery having 50.29 per cent coefficient of variation.

4.3 FDI FLOWS IN POST-REFORM PERIOD

4.3.1 Policy Framework

After mid 1990, the political instability with other economic problems given rise to severe financial crisis in the Indian economy. The high rate of inflation, fiscal deficit and a rapid rise in the external debt coupled with political uncertainty has degraded the international credit of the country. The decreased credit rating of the country resulted in the erosion of the international confidence in the Indian economy. The outflow of deposits especially by NRIs, a virtual stoppage of remittance from Indian workers in the Gulf and a sudden broke out of Gulf war in January 1991, has exacerbated the balance of payment crisis. The foreign exchange become so meagre that it was even insufficient to pay for one-week imports.

The government in April 1991, has come up with certain measures which includes the compression of imports by requiring a 200 per cent cash margin or release of foreign exchange, cutting canalized imports, tightening the issue of replacement licenses to exporters and restructuring the issue of new letters of credit for capital imports. The need of foreign capital to supplement the domestic saving and the requirements of foreign exchange to pay for imports as well as to correct the balance of payment problems was conditioned by the IMF and World Bank for introducing the New Economic Policy measures of macroeconomic stabilization and structural adjustment programmes.

In June 1991, the government initiated a programme of macroeconomic stabilisation and structural adjustment which includes liberalized trade regime characterized by the absence of discretionary import licensing and tariff rates comparable to other developing countries, an exchange rate system free of allocative restrictions for trade and an efficient and dynamic industrial sector subject only to regulations relating to environmental security, strategic concerns, industrial safety and unfair trading practices.

A real thrust to New Economic Reform Policy measures has come into being in the form of New Industrial Policy measures announced on 24 July 1991. This policy measures delicensed all the industrial licenses except for the 18 industries specified in the Annex-II of the statement, which includes those industries, which manufactured hazardous chemicals and items of elitists consumption or of national concerns, social well-being or the environment. Automatic clearance for imports of capital goods up to 25 per cent of the total value of plant and equipment subject to a maximum of Rs. 20 million was allowed.[15]

In 34 high priority industries identified in the Annex-III of the policy, foreign investment up to 51 per cent permitted automatically provided the foreign equity inflows was sufficient to cover the cost of imported capital goods. The remittance of dividends was to be balanced by export earnings over a period of (seven years from the commencement of the production). Foreign equity proposals no longer required to be accompanied by foreign technology agreements. Trading companies engaged primarily in export activities were allowed up to 51 per cent foreign equity.

Since 23rd September 1992, the government has constituted an Empowered Committee to deal with FDI proposals recommended by FIPB in which total investment was up to Rs. 300 crores. Proposals involving total investments beyond Rs. 300 crores were referred to the Cabinet Committee on Foreign Investment. A special empowered Board was constituted to negotiate with large international firms and approve foreign direct investment in selected areas.[16]

The New Industrial Policy also accorded automatic permission to foreign technology collaborations in high priority industries up to a lump sum payment of Rs. 10 million, 5 per cent royalty for domestic sales and 8 per cent for exports, subject to a payment of 8 per cent (net of taxes) of sales over a 10 years period from the date of agreement or 7 years from the date of commencement. No permission was required for hiring foreign technicians or foreign testing of indigenously developed technologies. The requirement of prior approval of the government for establishment of new undertakings, effecting expansion, amalgamation etc under the MRTP Act was eliminated.

In order to attract multinational enterprises to the energy sector, 100 per cent foreign equity was permitted in the power sector. International companies were allowed to explore non-associated natural gas, develop gas fields, including laying down pipelines and set up liquified petroleum gas projects. A new package for 100 per cent Export Oriented Units (EOUs) and units in the EPZs was announced including automatic clearance for proposals fulfilling the specified parameters on capital goods, import, location value and addition etc.

In order to deal with the cases related to foreign investment, FIPB was constituted and has been authorized to provide a single window clearance for all project proposals considered by it. In October 1991, the government allowed up to 100 per cent equity ownership by NRIs and OCBs predominantly owned by them in high priority industries (as specified in the NIP measures of July 1991), with repatriation benefits, provided equity inflows covered capital good import, and dividend remittances were balanced for seven years. In addition, the 1991 policy measures invited foreign equity holdings up to 51 per cent by international trading companies. In addition to hotels, 51 per cent equity was also welcomed in other tourist related areas.[17] The NRIs and OCBs predominantly owned by them was allowed to invest up to 100 per cent equity in high priority industries, hitherto eligible for 74 per cent and 51 per cent equity investment respectively. These investments through the automatic approval route of RBI have full benefits of capital repatriations. NRIs investments up to 100 per cent of equity is also allowed in export houses, star trading houses, hospitals, EOUs, sick industries and hotels etc.

In January 1992, the government decided to allow the use of foreign brand names for goods manufactured by the domestic industry. The existing companies could also switch over to foreign brand names for hybrid names with governments permission. In addition FERA companies were also allowed to open branches, use of their trademarks, carryout any activity of a trading, commercial or industrial nature, borrow money and accept fixed deposits like any other Indian company.

The rupee was made partially convertible in the budget 1992-93, under which 60 per cent of export earnings were converted at the market determined exchange rate under the provision of Liberalized Exchange Rate Management System (LERMS). On April 13, 1992 India singed the convention of the Multilateral Investment Guarantee Agency (MIGA) for the protection of foreign investment. In the same month foreign investors in the power sector were permitted to drawn upon financial resources from Indian financial institutions to the extent of 40 per cent of their total fund requirements.

In June 1992, foreign equity procedures were revised which liberalized the share valuation procedure to be followed while issuing new equity shares to foreign investors. The dividend balancing clause was withdrawn on all foreign investment approvals except for 22 specified consumer goods industries. In July 1992, conditions imposed on letters of intent and industrial licenses granted before the NIP 1991, measures. Such as those concerning export obligations, foreign exchange neutrality and prohibition of access to domestic financial institutions were withdrawn. The government has also made effective FIPB since July 1992. In August 1992, the oil majors were offered 51 per cent ownership in joint ventures set up for development of known oil fields.[18]

Since September 1992, the government has constituted an Empowered Committee to deal with FDI proposals recommended by the FIPB in which total investment was up to Rs.300 crores. The proposals involving total investment beyond Rs. 300 crores were left for the cabinet committee on foreign investment.[19] In September 1992, the government again announced guidelines for Foreign Institutional Investors (FIIs) in

the Indian capital market. Foreign Institutional Investors were allowed to invest in all types of securities traded in the primary and secondary market with full repatriation benefits and without restriction on either volume of trading or lock in period. The guidelines were further liberalized in November 1992, to permit FIIs to apply for shares from quotas reserved for Indian mutual funds, NRIs financial institutions and employees.

In January 1993, the government permitted FERA 1973, companies to acquire and hold a movable property in India or setting up joint ventures abroad. Under this provision companies with more than 40 per cent of foreign capital were permitted to engage in the establishment of branches, purchase of real estate, fund raising, acquisition of companies and employment of expatriate advisers on equal basis with domestic companies all of which have facilitated new investment by foreign firms.[20] In January 1993, a package of financial sector reforms was announced that allowed permission to new private sectors including foreign Joint ventures banks to operate.

The 1993-94, budget further reduced tariff rates on a number of items and made the rupee fully convertible. In March 1993, a new mineral policy allowed foreign participation along with private sector in the mining of 13 minerals, which was reserved exclusively for the public sector. It has raised the foreign equity participation up to 50 per cent in Indian mining companies. The mineral and metal processing units were allowed to develop captive mines and were also allowed to foreign equity participation in the manner and to the extent already permitted to such

processing units. The equity participation of over 50 per cent by foreign parties in non-captive mines was also considered on a case to case basis.

In April 1993, the licensing policy was further liberalized and the government delicensed the manufacture of motorcars white goods like refrigerators, air conditioners and washing machines and raw hides, skins and patent leather. The number of industries requiring compulsory licensing was reduced from 18 to 15. In April 1994, the government offered identified highways and bridges to the private sector including foreign investors to build, maintain and operate on toll collection basis. In May 1994, the government announced its intention to allow private including foreign companies to operate telephone service networks in the country. The liberalization of policies has been accompanied by active courting of foreign investors at the highest level.

In December 1996, the government allowed automatic approval for foreign direct investment up to 74 per cent through RBI in 9 categories of industries. The list of items for automatic approvals of foreign equity by RBI was expanded by including 3 industries relating to mining activity, for foreign equity up to 50 per cent and 13 additional industries for foreign equity up to 51 per cent. The 48 industries related to mining activity eligible for automatic approval up to 50 per cent foreign equity and another set of industries eligible for 74 per cent foreign equity was also considered. The industries in which automatic approval has been granted include a wide range of industrial activities in the capital goods and metallurgical industries. Besides, this includes a number of other industries, which are important for the rapid growth of the economy. Since February 28, 1996 NRIs and not OCBs were permitted to invest

funds on non-repatriation basis in money market mutual fund floated by commercial banks, public and private sector financial institutions.[21]

In January 1997, the government has come up with the exhaustive list of guidelines for foreign direct investment, which were not covered under automatic approval. These guidelines specify the priority areas for foreign direct investment proposals which includes infrastructure, export potential, large scale employment potential particularly for rural areas, items linkages with the farm sector, social sector projects like hospitals, health care and medicines and proposals that lead to the induction of technology and infusion of capital. FDI approvals was however subject to sectoral caps; 20 per cent (40 per cent for NRIs), in the banking sector; 51 per cent in the non-banking financial companies; 100 per cent in power, roads, ports, tourism and venture capital; 49 per cent in telecommunications; 40 per cent (100 per cent for NRIs) in the domestic air taxi operation airlines; 24 per cent in small scale industries; 51 per cent in drugs / Pharma industries for bulk drugs; 100 per cent in petroleum and 50 per cent in mining except for gold, silver, diamond and precious stones.

The 1998-99, budget brought several measures which were taken to boost foreign investment, which includes (i) NRIs allowance to purchase shares in Indian companies in the secondary market subject to a limit of 5 per cent of the companies total equity with a 10 per cent limit for aggregate NRIs /OCBs investment in the companies (ii) SBI launched a Resurgent India Bond (RIB) Scheme denominated in the foreign currencies and was open to both NRIs / OCBs and the banks acting in fiduciary capacity on behalf of them (iii) the projects for electricity generation, transmission and distribution as also roads and high ways, ports and harbours and vehicular tunnels were permitted foreign equity

participation up to 100 per cent under the automatic route, provided foreign equity does not exceed Rs. 1,500 corer (iv) the equity participation in private sector banks, multilateral financial institutions have been allowed to contribute equity to the extent of the short fall in the NRIs holdings within the overall permissible limit of 40 per cent (v) the government allowed 49 per cent of the total equity, subject to license in companies producing Global Personal Communications by Satellite (GMPCS) services (vi) NRIs / PIOs (Persons of Indian Origin), OCBs have been allowed to invest in unlisted companies under certain conditions (vii) FIIs are permitted to sell and purchase government securities and Treasury Bills within the overall debt ceilings (viii) 10 per cent FIIs debt funds have been permitted to invest in unlisted debt securities of Indian Companies.

The 1999-2000, budget also brought several measures which includes (i) the extensive list of automatic clearance for foreign direct investment which covers the important industrial and service sectors (ii) the FIPB was required to give clearance within 30 days (iii) the government decided to create Foreign Investment Implementation Authority (FIIA) for the quick transfer of foreign direct investment approvals into actual investment (iv) the automatic approval up to 100 per cent was allowed for NRIs / OCBs for all items except those fall under the industrial policy or are reserved for the small scale sector.

In the budget 2000-01, foreign direct investment policies have been gradually liberalized and all foreign direct investments were permitted under the automatic approval route, except for a small negative list. In a major effort to encourage investment in e-commerce, FDI up to 100 per cent has been permitted in the sectors subject to specific conditions. The dividend balancing conditions for FDI in 22 consumer goods industries

have been dropped. The existing upper limit for Rs. 1500 crores for FDI in projects involving electricity generation, transmission and distribution (other than atomic reactor plants) has been dispensed with.

For facilitating greater inflows of foreign funds in the crucial oil-refining sector, the ceiling for FDI under automatic route in the oil refining has been increased to 100 per cent from the existing 49 per cent. FDI under the automatic route has been permitted up to 100 per cent for all manufacturing activities (with certain exceptions) in the Special Economic Zones (SEZs). Foreign equity participation up to 26 per cent has been allowed in the insurance sector as prescribed in the Insurance Act 1999 subject to the issue of necessary licenses by the Insurance Regulatory and Development Authority. The 100 per cent FDI has also been allowed (with certain limitations) in the telecommunications sector or Internet Service Providers (ISPs) not providing gateway (both for satellite and submarine cables), infrastructure providers providing dask fibre (FP category), electronic mail and voice.[22]

In addition, the traditional Export Processing Zones (EPZs) has been transferred in the Especial Economic Promotions Zones (EPZs). It proposed the 100 per cent FDI investment through the automatic route to manufacturing activities in SEZs, except for the following (a) arms and ammunition, explosives and allied items of defence equipment, defence aircraft and warships (b) atomic substances (c) Narcotic and Psychotropic substances and hazardous chemicals (d) distillation and brewing of alcoholic drinks and (e) cigarettes /cigars and manufactured substitutes.[23] In addition, in SEZs the manufacturing units were not subject to the routine examination by customs of export and import, the inputs are allowed on self-certification basis, the duty free materials are allowed for five years and a host of procedural simplification and operation like

record keeping, inter unit transfers, subcontracting, disposal of absolute materials etc.

From November 1, 2000 the Export Processing Zones at Kandla, Santa Cruz (Mumbai), Kochi and Surat have been converted into SEZs. An approval has also been given for setting up SEZs at Nanguneri (Tamil Nadu), Posita (Gujarat), Kulpi (West Bengal), Paradeep (Orissa), Bhadohi and Kanpur (Uttar Pradesh), Kakinada (Andhra Pradesh), Drongiri (Maharashtra) and Indore (Madhya Pradesh).

The major policies to attract FDIs during 2000-01 and 2001-02 budget includes-

(i) The automatic route for FDI except for a small negative list and whereby investors were required to inform RBI within 30 days of bringing in their investment and again within 30 days of issuing of shares

(ii) The holding companies namely Non Banking Financial Companies (NBFCs) were permitted to foreign equity up to 100 per cent

(iii) Foreign investors were allowed to set up 100 per cent operating subsidiaries without the condition to disinvest a minimum of 25 per cent of its equity to Indian entities subject to bringing in US $50 million out of which US $7.5 million to be brought up and the balance in 24 months. The joint ventures operating as NBFCs that have 75 per cent or less than 75 per cent foreign investment allowed to set up subsidiaries for undertaking other NBFCs activities subject to the subsidiaries also complying with the applicable minimum capital inflow

(iv) FDI up to 49 per cent from all sources is permitted in the private sector on the automatic route subject to RBI guidelines

(v) FDI up to 74 per cent is permitted for the following telecom services subject to licensing and security requirement proposals, with FDI beyond 49 per cent shall require prior government approval (a) internet service providers with gateways (b) Radio and Raging and (c) End-to-end band with

(vi) Payment of royalty up to 2 per cent on exports and 1 per cent on domestic sales has allowed under automatic route on the use of trademarks and brand names of the foreign collaborator without technology transfer. Payment of royalty up to 8 per cent on exports and 5 per cent on domestic sales by wholly owned subsidiaries to the offshore parental companies were allowed under automatic route without any restriction on the duration of royalty payments

(vii) Offshore venture capital funds/companies were allowed to invest in domestic venture capital undertakings as well as other companies through automatic route without any restriction on the duration of royalty payments

(viii) FDI up to 100 per cent is permitted in airports with FDI above 74 per cent requires approval from the government

(ix) FDI up to 100 per cent is permitted with prior approval of the government in courier services subject to existing laws and exclusion of activities relating to distribution of letters

(x) FDI up to 100 per cent is permitted with prior approval of the government for development of integrated township, including housing, commercial premises, hotels, airports, city and regional level urban infrastructure facilities such as roads and bridges, mass rapid transit systems and manufacture of building material in all metros including associated commercial development of real

estate. The development of land and providing allied infrastructure form an integral part of townships development

(xi) FDI up to 100 per cent is permitted on the automatic route in the hotels, tourism and mass rapid transport including associated commercial development of real estate. FDI up to 100 per cent in drugs and pharmaceuticals (excluding those which attract compulsory licensing or produced by recombinant DNA technology and specific cell/tissue targeted formulations) placed on the automatic route

(xii) The defence industry sector is opened up to 100 per cent for Indian private sector participation, with FDI permission is up to 26 per cent both subject to licensing

(xiii) International Financial Institutions like ADB, IFC, Commonwealth Development Corporation, German Investment and Development Company etc. were allowed to invest in domestic companies through the automatic route, subject to SEBI/RBI guidelines and Sector specific caps on FDI

4.3.2 Trends in FDI Flows

The 1991, New Economic Policy measures have revive the past policies and so far been able to rebuild foreign investors confidence in making investment outlets in India. The amount of foreign direct investment as presented in Table 4.4, has been increased from US $117.1 million in 1991 to US $1091.0 million in1994. It has been further increased from its peak of US $4522.6 million in the year 1997 to US $4082.8 million in the year 2001.

Table 4.4
Foreign Direct Investment in India: Approvals vs Actuals During 1991-2001

(US $Million)

Year	Approvals	Actuals	%Growth (Actuals)
1991	235.0	117.1	-
1992	1499.8	266.7	127.8
1993	2817.5	592.2	122.1
1994	4521.9	1090.0	84.1
1995	9892.6	2139.2	96.3
1996	10202.9	2934.7	37.2
1997	15113.5	4522.6	54.1
1998	7467.0	3232.6	-.28.5
1999	6588.4	3917.7	21.2
2000	8242.0	4303.9	9.9
2001	5695.7	4082.8	-5.1

Source: SIA News Letter (Various issues), and India's Investment Center, New Delhi.

Country-Wise Break-Up of FDI Flows

The country-wise break-up of foreign direct investment presented in Table 4.5(a), reveals the fluctuating trends over the years, though it has followed almost a similar pattern. The paramount feature is that almost all the leading investing countries have responded positively in response to liberalisaiton policies for few years and finally started reducing their share except for a few countries. Although, the share of the USA, Mauritius have decreased considerably but they are continues to be the largest sources for foreign direct investment flows during the period 1991-2001.

The flows of foreign direct investment from USA has increased from US $81.9 million that is 35 per cent of the total foreign direct investment

Table 4.5(a)
Country - Wise Break - Up of Foreign Direct Investment in India During 1991-2002

(US $Million)

Country / year	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1991-2001
USA	81.9	475.1	110.0	1111.8	2175.7	2838.4	3736.2	863.2	830.4	933.5	1043.0	15190.2
Mauritius	0.0	0.0	39.5	170.4	557.8	658.8	2871.2	767.2	883.3	16097.7	613.0	8170.9
UK	14.2	45.4	198.0	414.1	532.4	430.0	1236.5	775.7	688.2	91.5	1058.4	5484.7
Japan	23.2	235.4	81.9	127.8	467.1	420.1	524.9	310.9	370.4	184.1	155.8	2901.6
Republic of Korea	2.7	15.2	9.3	34.1	96.9	909.2	538.6	89.3	847.5	9.1	14.2	2566.1
Germany	18.4	33.3	56.0	181.5	413.2	434.1	593.6	206.9	265.5	132.1	87.7	2422.3
Netherlands	24.7	37.3	102.3	66.0	298.1	296.0	239.7	120.3	146.8	1.0	782.7	2114.9
Australia	1.2	30.0	9.4	123.8	464.0	235.5	118.9	639.2	150.7	13.7	17.9	1804.3
France	8.5	11.4	41.1	28.6	129.7	471.9	196.4	124.5	336.5	45.0	144.1	1537.7
Malaysia	0.1	28.7	2.7	8.0	427.5	12.0	579.5	436.9	27.0	3.5	22.4	1548.3
Others	60.5	588.0	1176.3	2255.8	4330.2	3496.6	4478.0	3132.9	2042.1	5218.7	1756.3	28533.5
Total	**235.4**	**1499.8**	**28917.5**	**4521.9**	**9892.6**	**10202.9**	**15113.5**	**7467.0**	**6588.4**	**8242.0**	**5695.5**	**72276.5**

Source : SIA News Letters (Various issues) and India's Investment Centre, New Delhi.

Note : Data on FDI are on Approval basis and has been transferred in from the exchange rates taken from the International Financial Statistics (Year Book),IMF,2003.

flows in 1991 to a peak of US $3736.2 million in 1997 and to US $1043.0 million that it becomes only the 18.3 per cent of the total foreign direct investment flows in the year 2001. This has been followed by UK whose share has increased from US $14.2 million that is 6.0 per cent of the total foreign direct investment flows in 1991 to a sum of US $1058.4 million that is 18.6 per cent of the total foreign direct investment flows in the year 2001.

In the year 1991, USA, Netherlands, Japan, Germany and UK were the five largest sources and account for the 70 per cent of foreign direct investment flows, whereas in the year 2001, the top five investors were UK, USA, Netherlands, Mauritius and Japan and they account for 61.4 per cent. A significant feature of the source country foreign direct investment flows reveals that except the few countries like Mauritius, UK, Netherlands, Malaysia and a few other countries almost all of the other leading countries have shown a declining share in foreign direct investment flows.

Country-Wise Break-Up of FDI With Selected Statistical Values

The previous table on country-wise Break-up of foreign direct investment reveals the fluctuating trends over the years. The country-wise break-up of foreign direct investment with other values can be had from the Table 4.5 (b), during 1991-2000.

It can be observed from the Table 4.5 (b) that the compound rate of growth of foreign direct investment during the period 1991-2000 was 19.65 per cent per annum. The top five countries which have the highest compound rate of growth were Mauritius with 42.10 per cent, Malaysia with 36.04 per cent, UK with 31.59 per cent, France 30.53 per cent and USA 21.61 per cent per annum.

Table 4.5 (b)
Country-Wise Break-Up of Foreign Direct Investment in India With Selected Statistical Values During 1990-2001

Country	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per year
USA	81.90	3736.20	1290.84	1153.04	89.33	Ln (USA)	5.50028 (7.91992)	.19565 (.10239)	.289	21.61
Mauritius	0.00	2871.20	688.90	877.79	127.42	Ln (Man)	3.59793 (3.28188)	.35134 (2.39111)	.450	42.10
United Kingdom	14.20	1236.50	498.61	409.61	82.20	Ln (UK)	3.98151 (5.36497)	.27450 (2.50865)	.412	31.59
Japan	23.20	524.90	263.78	166.08	62.96	Ln (JA)	4.47757 (8.16345)	.13600 (1.68179)	.239	14.57
Republic of Korea	2.70	909.20	233.28	354.33	151.89	Ln (SK)	2.65360 (2.07331)	.21295 (1.12850)	.124	23.73
Germany	18.40	593.60	220.21	188.17	85.45	Ln (Ger)	3.93013 (5.99134)	.16920 (1.74950)	.254	18.44
Netherlands	1.00	782.70	192.26	221.99	115.46	Ln (Neth)	4.18458 (3.46553)	.04427 (.17803)	.007	4.53
Australia	1.20	639.20	164.03	209.06	127.45	Ln (Aust)	2.87518 (2.34359)	.18747 (1.03643)	.107	20.62
France	8.50	471.90	139.79	147.43	105.47	Ln (Fran)	2.70727 (4.05819)	.26644 (2.70886)	.449	30.53
Malaysia	0.10	579.50	140.76	222.22	157.88	Ln (Mal)	1.13244 (.07004)	.30776 (1.29111)	.156	36.04
Total (Inclusive Others)	235.40	28917.50	8943.32	7804.33	87.26	Ln (TT)	7.55007 (9.74914)	.17941 (1.57129)	.215	19.65

Note: Figures in Parenthesis show t – values.

The top five countries in terms of foreign direct investment flows were USA, Mauritius, UK, Japan and South Korea and together they account for the 47.5 per cent Table 4.5(a) of the foreign direct investment flows had a coefficient of variations (at 89.33 per cent, 127.42 per cent, 82.20 per cent, 62.96 per cent, 151.89 per cent respectively) during the period 1991-2001. But the average compound rate of growth for the above mentioned countries was merely 26.72 per cent during the period 1991-2001. The highest coefficient of variations among the top ten countries that is the highest inconsistency is found with Malaysia having 157.9 per cent, whereas the strong stability has been found with the Germany with having coefficient of variation at 85.45 per cent in the total foreign direct investment flows during the period 1991-2000.

Sector-Wise Break-Up of FDI Flows

The sector-wise break-up of foreign direct investment provides an extensive list of items in which India is welcoming foreign direct investment as a part of its reform policies. The top ten sectors Table 4.6(a), which have received the largest amount of foreign direct investment during 1991-2000 includes, transportation industry, electrical and equipment, telecommunications, chemicals (other than fertilizers), fuels (power and oil-refinery), food processing industries, paper and pulp (including paper product), drugs and pharmaceuticals, miscellaneous, mechanical and engineering and textiles industries.

The transport industry has attracted the largest amount of foreign direct investment that is their share has been increased from US $1.8 million in 1991 to US $272.8 million in the year 2000. During the period 1991-2000, this sector has attracted 7.1 per cent of the total foreign direct investment

Table 4.6(a)

Sector-Wise Break-Up of Foreign Direct Investment in India During August 1991 to December 2000

(US $Million)

Sectors / year	1991	1992	1993	1994.	1995	1996	1997	1998	1999	2000	Total *1991-2000*
Transportation Industry	1.8	41.7	18.4	41.7	71.2	141.0	416.8	357.9	262.5	272.8	1625.8
Electrical Equipment (Including Computer Software)	3.2	35.1	50.6	93.0	155.8	216.5	366.5	190.6	163.4	267.3	1542.0
Telecommunications	0.0	0.0	0.5	4.5	39.3	212.5	326.3	421.9	50.1	152.6	1207.7
Chemicals (Other than Fertilizers)	16.5	27.6	73.1	135.7	84.1	166.0	226.1	257.8	110.5	119.7	1217.1
Fuels (Power and Oil Refinery)	0.7	3.8	17.2	28.2	96.3	98.6	419.8	136.6	173.8	107.7	1082.7
Food Processing Industries	0.9	22.4	45.4	66.8	47.7	181.0	142.6	57.4	94.0	49.5	707.7
Paper and Pulp including Paper Product	0.0	0 1	0 0	4.4	34.4	87.0	40.5	56.8	11.9	57.8	292.9
Drugs and Pharmaceuticals	5.0	2.3	42.2	12.5	13.2	68.5	51.8	20.3	17.6	46.3	279.7
Miscellaneous, Mechanical and Engineering	8.8	21.7	20.0	22.3	48.9	25.0	59.0	28.6	14.6	24.4	273.3
Textiles (include Dyed, Printed)	0.1	7.2	11.3	44.9	45.6	42.9	43.8	12.2	29.0	1.8	238.8
Others	80.1	104.8	313.5	636.0	1502.7	1695.7	2429.4	1692.5	2990.3	3204.0	14649.0
Total	**117.1**	**266.7**	**592.2**	**1090.0**	**2139.2**	**2934.7**	**4522.6**	**3232.6**	**3917.7**	**4303.9**	**23116.7**

Source : SIA News Letters and India's Investment Center

Note : Data on FDI are on received basis and has been transferred from the exchange rates taken from the International Financial Statistics (Year Book), IMF, 2003.

flows. This has been followed by electrical and equipment whose share has been increased from US $3.2 million in 1991 to US $267.3 million in the year 2000. Similarly, the above-mentioned sectors have been followed by the telecommunications whose share has increased to 3.5 per cent in 2000 from almost negligible in the year 1991. Likewise the above sectors chemicals (other than fertilizers) has just got 2.0 per cent, fuels (power and oil-refinery), around 2.5 per cent, food industries has got 1.2 per cent, drugs and pharmaceuticals 1.1 per cent and miscellaneous mechanical and engineering has just received 0.17 per cent in the total foreign direct investment flows in the year 2001.

Sector-Wise Break-Up of FDI With Selected Statistical Values

We have analyses the sector-wise break-up of foreign direct investment in India during 1991-2000, which shows that there is a inconsistency in FDI flows. The sector-wise break-up of foreign direct investment together with the compound rate of growth and other values can be had from the Table 4.6(b), during the period 1991-2000.

The Table 4.6(b), depicts that the compound rate of growth of foreign direct investment during the period 1991 2000 was 47.67 per cent. It can be said that the highest compound rate of growth of foreign direct investment among the top five sectors were, telecommunications with 103.41 per cent, paper products 82.85 per cent, fuels with 73.14 per cent, transportation industry 62.88 per cent and electrical equipment with 45.32 per cent per annum.

The top five sectors, which have attracted the bulk of foreign direct investment, were transportation Industry, electrical equipment, telecommunications, chemicals, fuels and together they account for the 28.88 per cent Table 4.6(a), have a coefficient of variation (at 93.86 per cent, 73.19 per cent,

Table 4.6 (b)
Sector Wise Break-Up of Foreign Direct Investment in India With Selected Statistical Values During August 1991 to December 2000

Sector	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per year
Transportation Industry	1.80	416.80	162.58	152.60	93.86	Ln (TT)	1.64352 (2.78736)	.48785 (5.13378)	.767	62.88
Electrical Equipment (including Computer Software)	3.20	366.50	154.20	112.85	73.19	Ln (EE)	2.48870 (4.22215)	.09499 (3.93425)	.659	45.32
Telecommunications	0.00	421.90	120.77	153.17	126.82	Ln (Tel)	.78852 (.43748)	.71007 (2.71515)	.551	103.41
Chemicals (other than Fertilizers)	16.50	257.80	121.71	78.46	64.47	Ln (Ch)	3.33111 (7.96995)	.21853 (3.24428)	.568	24.42
Fuels (Power and Oil Refinery)	0.70	419.80	108.27	124.53	115.02	Ln (Fuel)	.69251 (.92352)	.54891 (4.54206)	.721	73.14
Food Processing Industries	0.90	181.00	70.77	54.67	77.24	Ln (FPI)	2.05774 (2.46421)	.30840 (2.29160)	.396	36.12
Paper and Pulp including Paper Products	0.00	87.00	29.29	30.81	105.18	Ln (PP)	1.16526 (.71723)	.60351 (2.54331)	.519	82.85
Drugs and Pharmaceuticals	2.30	68.50	27.97	22.51	80.47	Ln (DP)	1.70230 (2.74580)	.22138 (2.21571)	.380	24.78
Miscellaneous, Mechanical and Engineering	8.80	59.00	27.33	15.28	55.89	Ln (MC)	2.82873 (7.68867)	.063271 (1.06718)	.125	6.53
Textiles (include Dyed, Printed)	0.10	45.60	23.88	19.22	80.48	Ln (Txt)	1.17111 (.88049)	.21826 (1.01822)	.115	24.79
Total (Inclusive Others)	117.10	4522.60	2311.67	1704.56	72.74	Ln (TT)	5.10782 (13.96072)	.38981 (6.61086)	.845	47.67

Note : Figure in Parenthesis show t – values.

126.82 per cent, 64.4 per cent and 115.02 per cent respectively) during 1991-2000. But the average compound rate of growth for the above sectors is 61.82 per cent during the above mentioned period.

The highest coefficient of variation among the top ten sectors has been found to be with telecommunications by 126.82 per cent, meaning thereby that this sector has a highest inconsistency in foreign direct investment flows whereas miscellaneous, mechanical and engineering have a strong stability with the lowest coefficient of variation with 55.89 per cent for the same period.

4.4 IMPACT OF FDI FLOWS ON INDIAN ECONOMY

Foreign capital has a significant bearing on the growth and development of the developing economies. The flows of FDI have a special significance in terms of benefits and costs due to its superiority over other forms of foreign capital. The objective is to see characters like profitability, capital intensity, and the degree of vertical integration, export intensity and the effective rate of taxation. It affects a wide range of economic variables such as exchange rates, interest rates, foreign exchange reserves, and domestic monetary conditions as well as saving and investment. Some commonly observed effects of capital inflows are exchange rate appreciation, monetary expansion, rise in bank rate landing if the capital flows are intermediated through banks and effects upon saving and investment. FDI flows supplements growth and development through contribution to capital formation. It improves export performance in the long run, through shifting of exports to technology advanced

countries. It not only implies benefits to the multinationals with accelerated growth and enhanced profits but also to host economies with transfer of technology, capital and improved management practices.

In theory foreign capital raises domestic expenditure in the economy, raising the demand for non-tradable goods that result in an appreciation of the real exchange rate. The price adjustment process then leads to the reallocation of resources from tradable to non-tradable goods switching of expenditure in favour of non-tradables. The rise in aggregate expenditure also increases the demand for tradable, leading to rise in imports and widening of the trade deficit.

The transmission channel of the real exchange rate appreciation however depends on the exchange rate regime, with a central bank intervention, the appreciation will take place through a normal route, but in a fixed exchange rate regime, the appreciation will work through an expansion in the domestic money supply, aggregate demand and the prices of non-tradable, capital flows are associated with high domestic savings, investment and economic growth. It may also raise private consumption, where inward and upward foreign capital translated into a stock market and a real estate boom that ultimately ended in financial and currency crisis or in Malaysia and Thailand are also well known. The flows of foreign capital in flexible exchange rate regime through effect on domestic money supply discourage speculation through increased exchange rate appreciation. The real exchange rate appreciation results a loss in external competitiveness, which hurt exports. This in turn lowers the profitability of the leading sectors of the economy and disrupts the

process of trade liberalization. If the flows are temporary then the real adjustment costs can disrupt the economic process within the economy. A study on the impact of MNCs on growth observed that such corporations have made significant positive contribution on growth of output and transfer of technology in developing countries. It has also noticed, improved export performance because of shift of exports to technologically advanced countries (WIR, 1992).

The foreign firms have significantly lower import intensities and capital labour ratios indicate that foreign firms tend to source domestically more than domestic firms. The foreign firms are generally more profitable than the local firms. This may include entry barriers, natural factors and degrees of product differentiation and industrialization of firms.

In south Asia, in particular TNCs did contribute to the process of growth and development. Many of the third world countries now view the TNCs as means of production to speed up technological progress. The phenomenal growth experience of China, which has been largely a function of private foreign capital, indicated that foreign capital could foster growth. Today's, TNCs control over the half of the world production and probably even larger percentages of world trade.

The New Industrial Policy resolution of 1991 accorded those foreign investments with technology transfer, marketing expertise, modern managerial techniques will pave the way for export promotion. The logic is that by virtue of their access to these channels they are better equipped to exports than their purely domestic counterparts. The import

substitution foreign direct investment can save as much foreign exchange as export oriented foreign direct investment. The impact of foreign direct investment depends upon the type of industry to which it refers. In Agro based industries foreign direct investment is likely to increase export given the relative price and income inelastic domestic demand for agricultural products. Again in the mineral sector foreign direct investment is likely to be export oriented simply because a high rate of depletion of resources is encouraged by the risk of expropriation through for e.g. nationalization. Although, the majority of the empirical work of TNCs have focused on the manufacturing sector.

The majority of the studies have adopted a comparative technology by analyzing the export performance of matched pairs of foreign and domestic firms and by including foreign ownership alongside other relevant independent variables as a multiple regression or discriminate analysis where the dependent variable is the export performance. This however is not surprising as export performance is not a function of only of the degree of foreign ownership. In particular, an export function would lead to take an account of firm industry and country specific factors apart from the issue of the multinational nature of firms (Kumar, 1990; Wilmore, 1992). The foreign firms have significantly lower import intensities and capital labour ratios indicate that foreign firms tend to source domestically more than domestic firms. The foreign firms are generally more profitable than the local firms. This may include entry barriers, natural factors, degree of product differentiation, and internationalization of foreign firms. In contrary to the general notion that

TNCs do not bring appropriate technology and due to their capital intensities methods they not only compete either local producers but also cause unemployment.

The Indian entrepreneurs are seriously affected by taking over their brand names by TNCs. The foreign collaborations although brings superior technology, but they have neither money nor the marketing networks with them. Similarly the increasing take over do not add to the new production capacities but they are likely to repatriate larger out flows of profits. In a recent study, it was observed that during 1991-92 to 1995-96 export orientation of 100 largest TNCs affiliates subsidiaries in India increased marginally from 8.07 per cent to 8.64 per cent, while the import dependence (import as a percentage of sales) nearly doubled from 6.86 per cent to 12.94 per cent. As a result these companies turned net looser of foreign exchange from a positive balance of Rs.270 crores to a deficit of Rs. 1,600 crores.[25] The share of exports to GDP has been increased from 7 per cent in 1990 to 14 per cent in 2001. The other macroeconomic variables has also been effected that is the share of gross domestic saving as a percentage of GDP has increased from 21.6 per cent in 1990 to 23.6 percent in 2001, whereas gross fixed capital formation as a percentage of GDP has been decreased from 25 percent in 1990 to 22.4 per cent in the year in 2001.The foreign exchange reserve has increased due to the increased activity of technology transfer, dividends, travels etc. from almost Rs.23 billion in 1990-91 to Rs. 264.0 billion in the year 2001-02.

The foreign direct investment entry in consumer goods sector like food and dairy products etc disrupts the productive capacity of the economy and causes unemployment. Thus, both from the point of view of pattern

of production and employment, the unrestricted entry of multinationals in soft areas have dangerous implications.

A larger inflow of foreign direct investment in the financial sector will lead to building of foreign exchange reserves, which will in turn expand domestic money supply and consequently, inflationary tendencies may get strengthened in the process. Although the inflation rate in India has come down from 12 per cent in the year 1990 to 3.5 per cent in the year 2001, but the correlation coefficient between FDI and inflation is found to be negative by (-.538) during the period 1991-2001 (Table 5.15). Moreover, the country is witnessing the growth of a vast non-baking financial and intermediate sector, which includes foreign financial companies and mutual funds. If this sector grows at a fast rate as is happening in India it may render any effort of the monetary management ineffective. The increasing number of takes over as a result of the rapidly rising MNCs shareholdings in Indian companies is thus swelling Indian concerns and disrupting the India's Indianisation process. This gives a serious set back to the private sector. The reforms and subsequent foreign investment flows seems to have positive impact on the economy. The qualitative changed have occurred in the operations of private foreign investment. The growth rate in gross domestic product and industrial production has been accelerated. The introduction of capital intensive techniques of production by MNCs in the height of abundant labour causes unemployment in the economy. That is technologies are not appropriate to absorb the surplus labour in the Indian economy. In other words, FDI contributes significantly to the investment activities in the host economy by augmenting the domestic investment. It leads to the

transfer of modern technology among, countries and promotion of competition in the host economy. It circumvents the foreign exchange gap to the growth process. It plays a macroeconomic role by determining the ease or difficulty with which policy makers can control inflation and economic activity. Traditionally, MNCs were dominated in the tea, pharmaceuticals and consumer products using existing small scale units to manufacture their products. Multinational corporations have flattened domestic competition in their product segments with the strength of their brand names and image of quality.[26]

The introduction of New Economic Reform measures has made a significant contribution on the FDI flows. It was just 0.3 per cent of GDP and 0.11 per cent of GDI in 1990. However, the percentage share for FDI in GDI has increased from 0.3 per cent in the year 1990 to 3.2 per cent in the year 2001. Likewise, its share in GDP has increased from 0.1 per cent in 1990 to 0.4 per cent in the year 2001. The correlation coefficient between FDI and a set of macroeconomic variables (Table 5.8) during the period 1990-2001 shows that it is highly correlated with exports (.879) and moderately correlated with gross domestic saving. Whereas it is found to be negatively correlated with inflation (Table 5.15).

4.5 CAUSES OF SLOW FDI FLOWS IN INDIA

It is a matter of fact that FDI in India has not come in a desired manner. Although, India is a latecomer in opening her economy but it is still unable to attract sufficient amount of foreign direct investment as compared to some of the developing economies. This is basically linked to its socio-economic set up and policies taken after independence. The

India's policy of cautious promotions after independence has disappointed foreign entities. During seventies, FDI policy was made more restrictive leading thereby to remove the worries during 1980s and 1990s. Throughout the last decade India follows the mid-way policy between being liberal and highly restrictive and in general is geared to encourage FDI in import oriented and in 100 per cent export oriented units. Although, these measures were taken,but there was a lack of clear cut transparency and bureaucratic hurdles cause confusion among the foreign investors. FDI flows have also been affected because Indian policy makers. more concerned about technology transfer and not much about investment. It is argued that FDI is expected to play a supplementary and subsidiary role since it was used as a vehicle for technology transfer. The complete web of regulatory control and bureaucratic intervention accompanied by the inadequate infrastructure particularly power, telecommunications and transportation is also regarded as major constraints.

The Indian statutes governing foreign investment were related to export oriented units and high in priority sectors. The export market was also not a major attraction despite its low costs and also being in uncompetitive in the world market. Thus the negligence on the part of wide consumer market becomes the obstacle in the flows of FDI.

The attempts to control foreign firms through instruments like FERA have been largely successful, but at the same time these measures have effectively discouraged new FDI. India like other countries has not pursued bilateral treaty and tabled talk from multinationals for the further course of FDI. The multiplicity of regulations and rules through RBI,

SIA, FIPB lack transparency in its approach. The delays in decision-making process cause confusion on the part of foreign investors. The high tariff rates and complicated customs administration reduced the FDI flows. Over the last few years it has been brought down but it is still a measure disincentive for foreign direct investment flows.

The delays in the convertibility of the rupee worry foreign investors regarding the safety of his capital in terms of complete freedom to remit not only his earnings in the form of dividends, royalties and management fees, but also high capital. It has acted as a disincentive on the part of foreign investors to make a long-term market commitment of their capital. The overall investment climate is held to be a more significant determinant of FDI. The becoming member of MIGA in the absence of any bilateral agreements for settlement of investment disputes with FDI supplying countries becomes a measure obstacle. The measures regulating FDI in India has been largely ineffective and lack continuity in designing foreign investment policy. The insufficient labour laws, lack of clarity and recently developed mergers and acquisition have restricted the potential of the country to attract sufficient amount of FDI.

4.6 MEASURES FOR FDI PROMOTION IN INDIA

Although, India has done well in attracting foreign direct investment flows but the potentiality of foreign direct investment flows so far has not been exploited. In other words, the opening up of India to foreign investment is likely to remain a slow and hesitant process. There was a growing recognition that if India's potentiality is effectively marketed India could attract significantly more inflows. There was a

growing belief in India that any credible attempt towards economic reforms must involve up gradation of technology, scale of production and linkages to the increasingly integrated globalised production system chiefly through the participation of the transnational corporations. However, despite such widespread liberalization, foreign investment remains concerned about the pace of implementation and wary about the irreversibility of the liberalization process. This has resulted in a "wait and watch" attitude on the part of some foreign investors either because they are not absolutely sure of the future or because of the expectation of securing a better policy package in the succeeding period. The current institutional system, therefore provide a mechanism for marketing of India as a location for foreign direct investment. Furthermore, it is also desirable to develop mechanism, which will have the private sector as an integral partner. There is also the need for modernizing existing industries to make them cost effective and internationally competitive and to encourage value-added exports on a larger scale and the corporate appraisal of a country's foreign direct investment policy as foreign direct investment involves long-term commitments.

India's trade regime with high tariff rates and complicated customs administration has not only affected foreign trade but also inflows of foreign investment. There are also the needs to introduce substantial reforms in its trade policy to boost foreign direct investment. The negative list of imports, especially in the consumer goods sector, can be pruned considerably. The average rate of tariff is quite high when compared to other countries. Many countries such as Indonesia and China permit duty free import of capital goods required by foreign enterprises.

Though, over the years custom duties have been brought down, the average rate of tariff is still quite high.

Although, India has become the member of Multilateral Investment Guarantee Agency (MIGA), it has so far not concluded bilateral agreements for settlement of investment disputes with the important foreign direct investment supplying countries. The magnitude of export oriented foreign direct investment attracted by a country is determined by more structural advantages than the incentives offered. An empirical study analyzing the inter-country pattern of export oriented foreign direct investment made by USA and new enterprises found the extent of export oriented foreign direct investment affected by a country to be determined by wage levels, industrial capacity and infrastructures of EPZs (Kumar, 1994).

The government policy towards foreign direct investment (e.g. incentives and performance obligations) or the overall international orientation of the economy did not affect significantly. Further though India have a large number of Free Trade Zones and 100 per cent export-oriented units providing similar benefit their functions hampered by location specific or infrastructure problems. These schemes require a greater attention of the policy makers in India. In terms of the policy areas, simplification of the entry routes, raising of equity ceiling of the operating system and procedures, IPR legislation and comprehensive dispute settlement system are critical and need to be updated.

The transfer of technology can be affected with more investment being made by technologically advanced multinational corporations. Critics do not distribute these gains, but the fact of the matter is that these

are aspects of foreign direct investment, which seriously impinge on people's welfare and national sovereignty. It is these aspects which we need serious consideration. To make Indian industry efficient and competitive in the world market we need to improve the conditions for technology transfer through technical collaborations, agreements and joint ventures by offering high royalty/lump-sum payments and larger agreements. There should be reduction in the high burden of taxation to international levels more so liberal terms for the remittance of profits higher royalties, longer periods for technical collaborations; and simple bureaucratic procedure.

The key policy issues of concern to India is of allowing the exchange rate change, sterilization, the soundness and capacity of the financial system to intermediate large volumes of capital inflows as well as the relative costs of particular policies.

Foreign direct investment has a comparatively positive role in social and economic infrastructure like power generation, steel, aluminum etc then the consumer goods sector. The recently widespread proliferation of foreign direct investment in consumer goods product i.e. soft areas not only increases our dependence but it is accompanied by the distribution of the productive capacity and widening of unemployment.

The foreign investors confidence should be strengthened that their investment is safe here. They are making investment outlets in those countries where all the infrastructure facilities are expanding continuously to meet the requirements of a growing economy and where the state is determined to find up the gaps in private investments in order to maintain and sustain industrial growth. Unless, India and its policies

are marked vigorously, the anticipated fallouts from policy liberalization will remain sub optimal.[27]

A reduction in the import duties of key raw materials and other inputs, which is imported by MNCs from their parent companies, would make them more competitive. So the reduction in input costs will lead to dominations of the domestic prices that are an increasing domestic market as well as more profit raising market share.

The approval system should be simplified. The numerous routes create confusion in the minds of prospective investors, which have to be reduced to one or two in, which equity percentages should be clearly defined. There should be center-state provisions for approvals, for acquisition of land, clearances for water, power connections, sales tax number etc. Some laws e.g. labour laws, urban land ceiling Act, the industry disputes Act, the sick industry companies Act, the packaging control regulations and the lube and grease control order have also to be identified. The role of the states should be positively defined. It is because these states provides the location, the infrastructure and the opening environs. The general laws and order situation in some states have been identified as an important factor for promoting foreign direct investment. Many states have lost out in the race for foreign direct investment because of bad laws and order situation leading to lack of investors' friendly environment. It is this whole package of laws, systems and procedures and not the foreign direct investment policy alone is considered by any farsighted investor.

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CHAPTER-5

Chapter – 5

DETERMINANTS OF FDI FLOWS IN SELECTED ASIAN COUNTRIES: AN ECONOMIC ANALYSIS

5.1 DETERMINANTS OF FOREIGN DIRECT INVESTMENT

Generally, there are a number of factors which affects foreign direct investment flows which includes political stability, economic stability, market growth, investment related laws and its transparency, infrastructure availability, taxation, production costs, availability of skilled labour and the level of technology. But there are a main category of two factors, which includes (A) Economic factors and (B) Policy factors.

A. Economic Factors

The economic determinants of inward foreign direct investment can be grouped for analytical convenience into three clusters, each of them reflecting the principal motivations of TNCs for investing in foreign countries namely, resource- seeking, market - seeking and efficiency-seeking. The evolutions of foreign direct investment regulations have affected these determinants in response to the focus of liberalization and globalization.

The availability of natural resources is the most important determinant of foreign direct investment in a country. In the Nineteenth Century, the bulk of foreign direct investment by European Union, United States and Japanese firms were promoted by the need to secure an economic and reliable source of minerals, primary products for industrializing nations of Europe and North America (Dunning, 1999). This can be reflected from the fact that up to the eve of the Second World

War about 60 per cent of the World stock of foreign direct investment was in natural resources. After the war, especially since the 1960s and 1970s the relative importance of natural resources as a host country foreign direct investment determinant has declined. This is basically due to decline in the importance of the primary sector in the world output and the emergence of large endogenous enterprises in many developing countries on which the most government rely for the production and distribution of raw or processed products. Another important determinants for inward foreign direct investment is the national markets. Accordingly, the relevant economic determinants for attracting market - seeking. FDI include market size in absolute terms as well in relation to the size and income of its population and market growth. The high growth of Asian markets reflected by the rate of growth of per capita GNP and the potential market size contributed to the high growth of foreign direct investment flows. The other related factors which includes the rapid expansion of individual country markets, including prospects for market growth throughout the region as well as existing market size and standard of living. The other factors which are important are wage rates, highly skilled labour force, industrial regulations, facilitated access to government contracts, implicit cost of labour, social institutions, labour union problems etc. Foreign investment is also attracted by the probability or confidence of earning relatively higher profits.[1]

B. Policy Factors

The policy framework is also one of the important determinants of foreign direct investment in a country. The speeding-up of liberalization and the simultaneous weakening up of its effectiveness as a determinant of foreign direct investment has extended the scope of policy framework. In particular, it has drawn attention to other policies that may affect

foreign direct investment flows but that have not been specifically considered in this context in the past. Foreign direct investment policy package consists of both tax and non-tax incentives. The tax incentives include inter-alia tax holidays, duty free import of capital equipment, intermediates and raw materials, accelerated depreciation, investment allowance, exemption from income tax and/or capital gains tax under specified conditions as well as exemptions from withholding taxes or dividends and interest rates. The non-tax incentives generally comprises permissibility of 100 per cent ownership, land ownership rights, repatriation of profits and capital guarantees against losses on account of nationalization, war or non-convertibility of currency, patent protections and speedy up approvals.[2]

The macro-organizational policies are those policies that affect the patterns of resource allocation as well as the structure and organization of economic activities, which have an important bearing on foreign direct investment flows. The structural policies influencing the industry composition of manufacturing (e.g. policies vis-à-vis sunset and sun rise industries), the spatial composition of economic activities (e.g. regional development policies), the functional composition of activities by type of ownership and intensity of competition (e.g. deregulation of service industries), policies towards building technological capacity. They have encouraged links for e.g. between foreign investors research and domestic industries through provision of tax credits or provided information and services to facilitate technological partnerships between domestic and foreign companies. The realization that almost all of these policies can affect foreign direct investment is relatively recent. It is now widely understood that environmental policies may facilitate foreign direct investment through creating a pool of potential suppliers of competitive

intermediate products to foreign affiliate. There are also policies determining the functioning of larger markets such as labour markets policies that may have either a discouraging or an encouraging impact on inward foreign direct investment.

The educational and health policies that raise the supply and quality of human capital in a country or policies that promote infrastructural development can improve a country locational advantage substantially and give it an edge over others. Foreign direct investment in an economy is being determined by the microeconomic factors (incentive schemes and the tax system) macroeconomic state of the economy, political stability and the continuity of its policy towards foreign investment. The macro variables are related to the status of the health of the economy and are taken to represent the investment climate in a country. The empirical results indicate that macroeconomic fundamentals are equally important in attracting foreign direct investment implying thereby that the macro economic policies have to be appropriate and they too provide incentives for attracting foreign investment.[3]

Macroeconomic policies are mainly monetary and fiscal policies, which determine the parameters of economic stability such as the rate of inflation and the state of external and budgetary balance, which, influence all types of investment. Since, they determine interest rates and the cost of capital in a host country, they directly affect one of the determinants of investment decision. The effects of interest rates on foreign direct investments are smaller than on domestic investments because TNCs normally have a greater choice of source financing.

Fiscal policies determines general tax levels, including corporate and personal tax rates and thereby influences inward foreign direct investment. Other things being equal a country with lower corporate tax

rates should stand a greater choice of attracting foreign direct investment projects than a country with higher rates. The personal tax rates may effects managers' choice as regards the location of regional headquarters and may affect the hiring of foreign personnel.

The technological improvements in transportation and telecommunication technologies have also provided TNCs with the ability to coordinate and manage their assets across borders and service markets anywhere in the world. Combined with their general management expertise, TNCs have now enhanced their capacity to manage global complexity, turning it into one of their ownership specific advantages. The transaction cost plays a role in shaping regional FDI patterns. This applies particularly to small investors with limited resources who tend to have a preference for foreign direct investment in neighbouring markets in order to keep transaction cost within manageable limits. The availability of cheap assets due to currency devaluation, declining stock market prices and a wave of restructuring of domestic firms including through mergers and acquisitions have affected FDI flows. The opening up of certain sectors, particularly in services and the relaxation of rules concerning ownership mode of entry and financing together with the good long term prospects of these economies contributed in foreign direct investment flows.

The high level of foreign exchange reserves in terms of the import cover reflects the strength of the external payment position and helps to improve the confidence of the prospective investors. Therefore, a positive relationship is postulated between the foreign exchange reserves and inflow of foreign investment. The exchange rate policy is related to the stability and may influence foreign direct investment decisions by

effecting the prices of host country assets, the value of transferred profits and the competitiveness of foreign affiliate exports.

Similarly, the high inflationary pressure erode the profitability of foreign investment, increases the cost of production and bring distortions in the host country economy. As a consequence, a negative relationship has been hypothensised between the rate of inflation and the flow of foreign direct investment.

Foreign direct investment is also driven by the factors that lie in the transaction cost of transferring technical and other knowledge and market imperfections. The more, the economies of production and marketing favour a foreign location, the greater is the inducement for foreign direct investment. The location-specific or country-specific advantages have an important bearing on foreign direct investment. Such advantages of particular host countries make foreign direct investment preferable not only to other potential host countries but also to domestic investment.[4]

The kind of capital flows whether official or private seems to be dependent on the income of the recipient country. The private capital inflows were predominant in high income countries for e.g. Hong-Kong and Singapore. While income may be important in determining the nature of the capital inflows. It is moderate in determining the nature of the capital flows and so in determining the share of foreign direct investment accruing to a country. In addition to the policies of host countries, other factors presumably explain the amounts of foreign direct investment in a country. In the case of Indonesia as well as Malaysia the abundance of petroleum and other natural resources is important. The size of the domestic market in Indonesia, the Philippines and Thailand and the favourable conditions for marketing in countries like Singapore, Hong

-Kong and South Korea are also presumably important in explaining the amount of foreign direct investment in a country.[5]

The policies of the developing countries towards foreign direct investment are also important elements in determining not only the amount but also the areas of foreign direct investment. As government increased control of natural resources through nationalization of foreign owned assets or restrictions on the entry of foreign capital into particular sectors. Foreign direct investment in manufacturing have increased partly in response to trade restrictions which were a part of the earlier national policies of import substitution as in Hong-Kong and Singapore and to serve domestic markets. Generally speaking, MNEs prefer to invest in developing countries with 100 per cent shareholding. This is facilitated by the favourable policies of the host countries, which were often compelled to adopt such policies. One of the reasons for this preference of multinationals is the advantage they get in internalization of business transactions. The proliferation of intra-firm trade is one of the results of the character of MNEs business practice.

The ability of the investors to substitute actual or potential foreign direct investment in one host region (or country) with foreign direct investment in another depends largely on the type of foreign direct investment as well as on the sector or industry concerned. The following points among the others are particularly relevant.

- Natural-resource-seeking foreign direct investment is largely location specific and where substitution is limited.
- Assets-seeking foreign direct investment as new opportunities in Asia.
- Efficiency-seeking foreign direct investment may also be attracted by factor costs in Asia.

Market-seeking foreign direct investment depends on the size and income growth of host countries. The concentration of markets in the effected countries in Asia is thus likely to reduce some market-seeking foreign direct investment in the short to medium term, but this does not necessarily mean a switch to other regions that would depend upon how attractive other regions are either relatively or absolutely.[6]

The general factors which discourages foreign direct investment flows includes among others political risk, exchange rate risk, macroeconomic risk lack of sufficiently skilled workers or managerial expertise,[3] lack of infrastructural facilities,[4] discriminatory government policies,[5] legal procedures pertaining to investments,[6] lack of investment code[7] and the lack of locally available skilled workers or effective managers.[8] The factors that discourages foreign direct investment flows in developing countries turns out to be higher cost associated with doing business in these countries in connection with the low productivity of factors of production. Production costs encompasses not only labour costs which are relatively lower but also transportation cost, telecommunication costs, distribution cost etc. The productivity is low due to the lack of labour houring in appropriate work organization, poor quality of administration and inadequate availability of business services.[7]

In spite of the above hindrance there are four major factors which contributed to the rise in foreign direct investment in Asia (1) the worsening of the competitive position of the Japanese companies caused by appreciation of the yen since 1993 (2) rising wages in the newly industrialised countries and (3) infrastructure improvement and technology upgradation in ASEAN countries putting them in better position to receive the transfer of higher technology products and (4)

rising final demand and the rapid growth attained by several countries of the region. Foreign direct investment in the region are driven by the efficiency seeking type i.e. outsourcing to achieve lower production cost and aimed at enlarging export market.

The stratification of the countries in East and South-East Asia can be done as follows (Dobson and Yue, 1997).[6]

Innovation driven – high firm value added

Hong Kong, Taiwan

Investment driven – high firm value added

Singapore

Investment driven – medium firm value added

Malaysia.

Factor driven – medium firm value added

Thailand

Factor driven – low firm value added

Goundong, Indonesia, Philippines.

In general there has been not only a sharp increase but also a fundamental shift in the pattern of foreign investment in the NIEs and ASEAN countries. The liberalization of domestic and investment regime has attracted more foreign investment. The flows of foreign direct investment in Asia has shifted over time from Asia NIEs to ASEAN and further to China broadly in line with the flying geese pattern. This has resulted in a rising wages and currency appreciation and had effected Asian NIEs as a destination for FDI flows. As a result these countries have become an output source for foreign direct investment flows for the region. Foreign direct investment has played a key role in the process of development in the region. As less developed countries have caught up with the more advanced ones, industrial restructuring has taken place

facilitated by FDI, that has enabled both the catching-up and the caught up countries to move upwards on the ladder of industrilisation while maintaining the international division of labour. This process of industrial development of Asian countries in which FDI has provided the required dynamism is reflected in the changing trade structure of the countries. As industries have been shifted from caught-up countries to the catching-up countries, the structure of the trade of the later group has transferred towards the trade structure of industrialised countries. The process of industrial development and industrial restructuring facilitated by FDI has caused the countries of the region to get increasingly internalized through linkages of trade, foreign direct investment and technology transfer. The countries of the East and South-East Asia are incorporated in the structure of division of labour in these region led by Japan, which has been and continues to be a supplier of basic materials, sophisticated parts and components of machinery.[8] The Japanese foreign direct investment has played a very important role in promoting the economic growth of East and South-East Asia, through cost reduction and export promotion.

The implication of the financial crises for inward foreign direct investments are not only confined to the five most seriously affected countries but the other developing countries has also been effected. The developing countries which was receiving the significant amount foreign direct investment has realized a fall in their share due to the reduced capacity of the investing countries, reduced growth rate and reduction in export competitiveness due to devaluations by the most effected countries. These are mainly the countries of East and South - East Asia, including China, Vietnam, the Asian least developing countries (Bangladesh, Cambodia, Lao Peoples Democratic Republic, Mynanmar) and Central Asia. The same considerations could also influence foreign

direct investment flows from developed countries to the less affected Asian developing countries in particular, the Japanese foreign direct investment were effected.[9] In other words it can be said that the eruption of the financial crises in East and South-East Asia has infact changed a number of major foreign direct investment determinants.

On the contrary the Asian countries most affected by the crises have ranked high among developing host countries in the attractiveness of their economies to foreign investors. In particular, they have built up fundamental strength that make for long term growth such as high domestic saving rates and skilled and flexible human resources thereby creating opportunities for foreign direct investment that is competitiveness enhancing for TNCs. They have also substantially liberlised their foreign direct investment policies and taken steps to facilitate business. In the short and medium term, the economic consequences of the financial crises will effect foreign direct investment flows to these countries, because they are likely to influence some of the determinants of foreign direct investment some in a manner conducive to attracting more foreign direct investment and others in a manner less favourable. Finally, it needs to be emphasized that with financial crises, Asia share in the total foreign direct investment going to all developing countries have declined.

The extent and nature of any foreign direct investment depends upon the precise combination of the economic opportunities available, and the friendliness of the policy framework and the ease of doing business in the country. Most of the studies have conclusively proven that market size and the growth rate are the principal determinates of the foreign direct investment flows. The income extents of urbanization, infrastructure quality, geographical culture proximity etc. are important

structural factors, which tend to favour foreign direct investment flows in the developed countries. The level of taxation, the business culture and the overall availability of economic and social infrastructure are the important determinants of the foreign direct investment. The improvements in any of these determining factors can relocate international production as capital is redirected to the country offering the highest real return on its investments.

5.2 REGULATORY FRAMEWORK FOR FDI

Foreign direct investment like most other economic activity thrives best in a stable, predictable and transparent environment. A major wave of liberalization began in the mid 1980s reflects the emergence of significantly less restrictive attitudes towards foreign direct investment in Asia. The most of the Asian countries have set-up a regulatory framework for attracting foreign direct investment. They have liberalized many of the previous restrictions on entry and establishment of foreign investors, reduced ownership control and authorization requirements and provided for legal guarantees and protection with respect to transfer of payments and repatriation of profits, intellectual property and expropriation. The other measures, which have been taken, include the simplification of investment approval process through the establishment of one-stop and the provision of information to companies on investment opportunities.[10] Tax incentives have also been granted to promote investment in specific industries and activities. The several aspects of the government policy regime may contribute to the perceived investment climate in the country including some elements of policy that apply to foreign enterprises such as performance requirements and fiscal incentives meant for industrial investment.

In addition to the setting up of legal framework at the national level, the Asian countries has conducted numerous bilateral, regional, interregional and multilateral level, agreements such as Bilateral Investment Promotion and Protection Treaties (BIPPTs) as well as Double Taxation Treaties (DTTs) which increased markedly over the past two decades.[11] These are numerous institutions that provide information to have broad support from several state agencies focusing on foreign direct investment promotion in Asia. These includes ASEAN investment corporation, the ASEAN Finance Corporation and the ASEAN Japan Corporation, the Japan-China Investment Promotion Organization (JIPO), JETRO, the Japan Overseas Development Corporation (JODEC), are the prominent one's which has been established to encourage foreign direct investment in Asian countries. Further, many of the Asian and Pacific countries have now signed the convention on the settlement of investment disputes between states and the nations of the other states (ICSID) and the Multilateral Investment Guarantee Agency (MIGA). The members of the ASEAN concluded in 1988, the framework for the gradual liberalization, protection and promotion of investment which were undertaken in the late 1990s notably by the committee on economic cooperation of SAARC and Thailand economic cooperation (BIMSTEC), the Indian Ocean Rim Association for Regional Cooperation (IORARC) and the Central and West Asian Economic Organisation.[12]

There are several types of boards/institutions, which promote foreign direct investment in respective countries. This includes the EDB of Singapore which is known for its efficiency with 20 offices overseas, which approves project in record time. The BKPM, the foreign investment approval authority of Indonesia is also known for being very

receptive to the needs of the foreign investors. China, through a little more complex has granted sufficient autonomy to the local administration to speed up the approval process. These factors may have proved vital to the success of these countries in attracting foreign direct investment. However in one respect, India scores over others. India is the only country where there is an automatic approval system. But as observed earlier, the efficiency of this route has been rather limited due to the very restrictive conditions imposed for coming through this route.

The tax incentives in China, Indonesia, Malaysia and Singapore consists of free import of capital equipment, tax holidays, accelerated depreciation investment allowance, exemption from withholding taxes on dividends interest etc. The other incentive includes ownership rights, repatriation of profits and fair compensation against nationalization, losses and patent protection etc. Tax polices in ASEAN countries can be summarized in the following manner (1) all countries provide exemption from import duties and taxes on capital equipment imported by promoted enterprises (2) Malaysia and Singapore provide additional deductions for certain types of capital expenditure (3) accelerated depreciation is provided in Malaysia and Singapore to promoted firms and (4) all countries except Indonesia grant income and the tax holidays is linked to the time period of foreign investment. China too grants preferential tax treatment to enterprises set up in SEZs and specified Coastal cities. Enterprises that quality as export-oriented or technologically advanced also avail of a 50 per cent reduction in the income-tax rate. A crucial characteristics missing in the Indian policy is the absence of tax exemption on imported materials and equipment. Some tax reductions, though is possible in the case of power projects, coal mining and Petroleum refining projects.

A major strength of Indonesian policy is that it permits 100 per cent ownership in practically every industry with a minor provision that at least 5 per cent should be diverted to an Indonesian partner within 15 years of the projects commercial production. Similarly, China permits wholly owned enterprises chiefly for high tech products benefiting the domestic economy substantially. This is probably based on the relationship that export-linked incentives in large markets like China will gradually fail to attract foreign investment. In India, foreign equity participation raised upto 100 percent except for the few sectors. Differences also exist with respect to the policies of South and South-East Asian countries. The first difference refers to the minimum level of foreign direct Investment. Thailand for e.g. does not permit foreign direct investment below 5 million baht and it insists that the foreign participation holds at least 25 per cent of the equity capital. Singapore encourages foreign direct investment exceeding one billion dollars. The Indian policy on the other hand is restrictive, limiting the maximum foreign equity participation generally to 51 per cent though FIPB has given discretionary powers to permit 100 per cent equity ownership in some areas. Another fairly common feature of the FDI policy is to give liberal tax concession to foreign enterprises. In some countries, the waivers of the equity restrictions on tax concession are linked to export performance and other important domestic policy parameters such as employment, local content and location. The Indian foreign direct investment policy nevertheless scores over the policies of other competing countries in the matter of employment of foreign personnel, whilst restrictions on the employment do not exist in India, they are prevalent in most countries in the Asian group as well as in China. In Malaysia and Indonesia, expatriate employment even for technical and

managerial positions requires justification in terms of non-availability of local skills. Singapore relaxes restrictions on employment of foreign personnel only under conditions of foreign investors providing manpower training at all levels in the enterprise to supplement and complement government efforts.[13]

A common characteristic of the foreign policy of the countries studied is remarkable degree of continuity. The existence of sound infrastructure facilities and favourable labour laws were the critical determinants of the foreign direct investment flows into these countries. Initially, foreign direct investment entered mainly due to low skill highly labour intensive industries like electronics assembly, sport goods, government etc. However, low labour costs were not the sole criterion as is evidenced from the flows of foreign direct investment to Malaysia rather than to Indonesia or the Philippines were the wage rates were considerably lower. The attraction was mainly for a disciplined labour force.[14]

The continuity of the policy and a stable macro-economic environment is essential for encouraging foreign direct investment flows in these countries. In the Chinese case recent trends in inflation and political instability have disappointed many investors. On the other hand the large discretionary powers of the BOI in the case of Thailand led to costly rent-seeking behaviour. In the case of India too, while measures regulating foreign direct investment have been largely ineffective, the lack of continuity in the foreign investment policies discouraged new foreign direct investment while encouraging rent seeking behaviour in the economy. There are also the tax policies in these countries, which have been geared towards encouraging large volumes of foreign direct investment with long term commitments.

The critical determinants of foreign direct investment seems to be infrastructural facilities as in the Guandong province of China, Judong in Singapore or the Penang Peninsula in Malaysia. The Chinese experience also has an important policy lessons for India. Given the large size of the Chinese economy, the greater degree of decentralization of powers in the hands of the local authorities allowed for a considerable freedom to make quick decisions in granting concessions to foreign direct investment. In India, in contrast the centralized decision making, creates cumbersome bureaucratic procedures, which create costly delays in the process of approval of foreign direct investment. Finally, it can be concluded that most of the Asian countries have gradually liberlised their economies and the number of countries that changed their investment regimes has increased from a mere 35 in 1991 to as many as 71 by the year 2001. The number of regulatory changes introduced by the different countries of the world has also increased from 82 in 1991 to 208 in 2001 and as expected most of the regulatory changes were brought about to make foreign direct investment more favourable.[15]

There has however, been a growing realization that steps towards making the foreign investors feel more secure about their investment through patent protection, guarantee permissibility of repatriation of profits capital etc. are more effective in attraction of foreign direct investment than fiscal-cum financial incentives. The importance of sound macroeconomic management also cannot be undermined. Countries, registering high growth rates succeeded in attracting foreign direct investment more easily than others. This is corroborated by the fact that the most of global flows occur between the developed and the developing countries. Experience of the ASEAN region as well as in China shows

that a growing markets size is one of the strongest incentives for foreign investors.

5.3 TRENDS IN FDI FLOWS

Asian economies are one of the fastest growing economies in the world, which is evident from the realisation of sound macroeconomic variables. FDI has played a major role in the growth and development of Asian economies. This can be signifies from the fact that since mid – 1980s, the major wave of Liberalisation has brought the emergence of significantly less restrictive regime which not only includes the liberal policy framework but also a host of tax incentives, sound infrastructures availability, bilateral and multilateral treaty agreement etc. The share of Asia in FDI flows in the world has been increased from 12.0 per cent in 1990 to 13.9 per cent in the year 2001. Although the amount of FDI in Asia has increased from US $24251 million in 1990 to US $102066 million in 2001, but its share in the developing countries has been decreased from 64.6 per cent to 49.8 per cent during the above mentioned period.

Table 5.1(a) shows the FDI flows in selected Asian countries where the share of Singapore, China, Hong-Kong, Thailand and Taiwan has increased from 70 per cent in 1990 to 84.4 per cent in the total FDI flows in the year 2001. The share of selected Asian countries under study namely China, Indonesia, Thailand, Singapore, Malaysia and India have been decreased from 64.1 per cent in 1990 to 58.7 per cent in the year 2001. FDI flows in China has been increased from US $3487.0 million in 1990 that is its share has been increased from 14.4 per cent in 1990 to US $46846.0 million that is 45.9 per cent in the year 2001. The share of Hong - Kong has been increased from US $3275.0 million that is 13.5

Table 5.1(a)
Foreign Direct Investment in Selected Asian Countries During 1990-2001

(US $ Million)

Sector / Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total 1990-2001
China	3487.0	4366.0	11156.0	27515.0	33787.0	35849.0	40180.0	44237.0	43751.0	40319.0	40772.0	46846.0	372265.0
Hong-kong	3275.0	1021.0	3887.0	6930.0	7828.0	6213.0	10460.0	11368.0	14770.0	24596.0	61938.0	22834.0	1751209.0
Singapore	5575.0	4887.0	2204.0	4686.0	8550.0	8788.0	8608.0	10746.0	6389.0	11803.0	5407.0	8609.0	86252.0
Malaysia	2611.0	4043.0	5138.0	5741.0	4581.0	5816.0	7296.0	6324.0	2714.0	3895.0	3788.0	554.0	52501.0
S Korea	789.0	1180.0	728.0	588.0	809.0	1776.0	2325.0	2844.0	5412.0	9333.0	9283.0	3198.0	38265.0
Thailand	2562.0	2030.0	2114.0	1805.0	1364.0	2068.0	2271.0	3626.0	5143.0	3561.0	2813.0	3759.0	33116.0
Taiwan	1330.0	1271.0	879.0	917.0	1375.0	1559.0	1864.0	2248.0	222.0	2926.0	4928.0	4109.0	23628.0
India	237.0	75.0	252.0	532.0	974.0	2151.0	2525.0	3619.0	2633.0	2168.0	2319.0	3403.0	20888.0
Indonesia	1092.0	1482.0	1777.0	2003.0	2108.0	4346.0	6194.0	4677.0	-356.0	-2745.0	-4550	-3277.0	12751.0
Turkey	684.0	810.0	844.0.0	636.0	608.0	885.0	722.0	805.0	940.0	783.0	982.0	3266.0	11965.0
Others	2609.0	3107.0	3986.0	7363.0	6525.0	5766.0	10886.0	15334.0	14491.0	6140.0	6027.0	8765.0	90999.0
Asia	24251.0	24272.0	32965.0	58716.0	68509.0	75217.0	93331.0	10582.0	96109.0	102779.0	133707.0	10206.0	917750.0

Source: World Investment Report (Various issues), UNCTAD.

per cent in 1990 to US $22834 that is 22.4 per cent in the year 2001. This has been followed by Singapore whose share has been decreased from 22.9 per cent in 1990 to 8.4 per cent in the year 2001.

The share of Malaysia and Indonesia has been decreased from 10.8 per cent and 4.5 per cent in 1990 to 0.5 per cent and 3.2 per cent respectively in the year 2001. The share of other countries stood at 4 per cent for Taiwan and 3.2 per cent for South Korea in the total FDI flows in the year 2001.

FDI Flows and Selected Statistical Values

The previous table on FDI flows in Asia shows the four-fold increase during the period 1990-2001. The break-up of FDI flows together with the compound rate of growth and other statistical values can be had from the Table 5.1(b), during the period 1990-2001.

It can be observed from the table that the compound rate of growth of FDI during the period 1990-2001 was 16.27 per cent per annum. The top five countries in terms of highest compound rate of growth includes India with 35.72 per cent, Hong-Kong 30.73 per cent, Indonesia 26.98 per cent, S. Korea 26.34 per cent, China 23.74 per cent per annum.

The top five countries as a recipient of FDI were China, Hong-Kong, Singapore, S. Korea and Taiwan and together they account for the 75.8 per cent Table 5.1(a) in the total FDI flows had a coefficient of variation (at 51.05 per cent, 113.89 per cent, 38.72 per cent, 99.61 per cent and 70.35 per cent respectively) during the period 1990-2001. But the average compound rate of growth for the above mentioned countries was merely 19.6 per cent. The highest coefficient of variation among the top ten countries is found to be for Indonesia with 310. 60 per cent, showing highest inconsistency where as the Singapore with 38.72

Table 5.1 (b)
Foreign Direct Investment in Selected Asian Countries With Selected Statistical Values During 1990-2001

Country	Minimum	Maximum	Mean	Standard Deviation	Coefficient of Variation	Dependent Variable	Intercept	Regression Coefficient	R-Squared	CRG (%) Per Year
China	3487.00	46846.00	31022.08	15837.38	51.05	Ln(Ch)	8.69508 (25.71726)	.21300 (4.63662)	.683	23.74
Hong Kong	1021.00	61938.00	14593.33	16620.53	113.89	Ln (Hk)	7.35849 (24.72372)	.26799 (6.62712)	.815	30.73
Singapore	2204.00	11803.00	7187.67	2783.32	38.72	Ln (Sing)	8.34860 (33.19005)	.06871 (2.01042)	.182	7.11
Malaysia	554.00	7296.00	4375.08	1859.95	42.51	Ln (Mal)	.23889 (21.72737)	-.07738 0.70625)	.167	8.05
Republic of Korea	588.00	9333.00	3188.75	3176.21	99.61	Ln (Kr)	6.110640 (18.96254)	.23410 (5.35048)	.741	26.34
Thailand	1364.00	5143.00	2759.67	1071.93	38.84	Ln (Th)	7.42440 (40.08972)	.06666 (2.64920)	.412	6.89
Taiwan	222.00	4928.00	1969.00	1385.09	70.35	Ln (Tw)	6.70429 (14.08354)	.09644 (1.49111)	.182	10.12
India	75.00	3619.00	1740.67	1268.09	72.85	Ln (Ind)	4.98256 (12.01390)	.30541 (0.54199)	.746	35.72
Indonesia	-4450.00	6194.00	1062.58	3298.4	310.60	Ln (Indo)	6.74923 (40.20988)	.23889 (7.18898)	.896	26.98
Turkey	608.00	3266.00	997.08	723.67	72.58	Ln (Tur)	6.30421 (27.97780)	.07341 (2.39791)	.365	7.62
Total	24251.00	133707.00	76479.17	35521.52	46.45	Ln (Tot.)	10.12886 (65.28401)	.15073 (7.15027)	.836	16.27

Note: Figure in the Parenthesis show – t values.

per cent coefficient of variation is having strong stability in the FDI flows during the period 1990-2001.

5.4 FOREIGN DIRECT INVESTMENT AND MACRO ECONOMIC PERFORMANCE IN SELECTED ASIAN COUNTRIES

The impact of FDI flows in selected Asian countries namely China, Indonesia, Thailand, Singapore, Malaysia and India has been assessed by First determining the inter-relationship between independent variables and secondly by determining the precise role of various macro economic variables through factor analysis, during the period 1990-2001. The variable considered for this purpose is shown in Table 5.8, where X_1, X_2.....X_n has been defined.

5.4.1 Inter-relationship among Independent Variables in China

For determining the inter-relationship among the independent variables, each variable has once been considered as dependent variable and then its relationship with other variables is correlated. The results thus, obtained are tabulated in Table 5.2.

Table 5.2
Correlation Coefficient Matrix for (of the independent variables) China during 1990-2001

	X_1	X_2	X_3	X_4	X_5	X_6	X_7	X_8	X_9
X_1	1.000								
X_2	0.890	1.000							
X_3	0.881	0.980	1.000						
X_4	0.843	0.949	0.961	1.000					
X_5	0.853	0.973	0.973	0.978	1.000				
X_6	0.922	0.993	0.980	0.937	0.965	1.000			
X_7	0.931	0.989	0.981	0.947	0.955	0.994	1.000		
X_8	0.896	0.991	0.981	0.967	0.972	0.989	0.992	1.000	
X_9	-0.092	-0.475	-0.415	-0.327	-0.428	-0.432	-0.378	-0.420	1.000

The correlation of foreign direct investment with other variables indicates that it is highly correlated with GDCF (.931) followed by GDS (.922). It is moderately correlated with GFCF (.896), GDP (.890), GNP per capita (.881), exports (.853), imports (.843) and negatively correlated with inflation (-.092).

When GDP is taken as dependent variable it is found that it is highly correlated with GDS (.993), followed by GFCF (.991), GNP per capita (.980), GDCF (.989), exports (.973) and imports (.949). It is moderately correlated with FDI (.890) and negatively correlated with inflation (-.475).

The assessment of GNP per capita reveals that it is highly correlated with GDCF (.981), GFCF (.981), followed GDS by (.980), GDP (.980), exports (.973) and imports (.961). It is moderately correlated with FDI (.881) and negatively with inflation (-.415).

When import is taken as dependent variables its correlation with independent variables are strong with export (.978) followed by GDCF (.967), GNP per capita (.961), GDP (.949), GDCF (.947) and GDS with (.937). It is moderately correlated with FDI (.843) negatively correlated with inflation (-.327).

When export is taken as dependent variable its correlation with independent variables is very high with import (.978), followed by GNP per capita (.973), GDP (.973), and GDCF (.972) and GDS (.965). It is moderately correlated with FDI (.853) and negatively correlated with inflation (-.428).

When gross domestic saving is dependent variable its correlation with independent variable is high with GDCF (.994) followed by GDP (.993), GFCF (.989), GNP per capita (.980), export (.965), import (.937) and FDI (.922), whereas it is negatively correlated with inflation by (-.432).

When gross domestic capital formation is taken as dependent variable its correlation with independent variables is very high with GDS (.994), followed by GFCF (.992), GDP (.989), GNP per capita (.981), export (.955), import (.947) and FDI with (.931), whereas it is negatively correlated with inflation (-0.378).

Likewise, the dependent variable gross fixed capital formation asserts that it is strongly correlated with GDCF (.992) followed by GDP (.991), GDS (.989), GNP (.981), exports (.972) and import (.947). It is mildly correlated with FDI (.896) and is negatively correlated with inflation (-.420).

Finally, the correlation of inflation with other independent variable asserts that it is negatively correlated for all the variables. It is inversely with GDP (-.475) followed by GDS (-.432) and is moderately correlated with GDCF (.378) and FDI (-.092).

5.4.2 Inter-relationship among Independent Variables in Indonesia

For determining the inter-relationship among the independent variables each variables has once been considered as dependent variable and then its relationship with other variables is correlated. The result thus, obtained are tabulated in Table 5.3.

Table 5.3
Correlation Coefficient Matrix for (of the independent variables) Indonesia during 1990-2001

	X_1	X_2	X_3	X_4	X_5	X_6	X_7	X_8	X_9
X_1	1.000								
X_2	0.638	1.000							
X_3	0.767	0.977	1.000						
X_4	0.556	0.906	0.853	1.000					
X_5	-0.340	0.266	0.148	0.545	1.000				
X_6	0.811	0.912	0.962	0.827	0.061	1.000			
X_7	0.910	0.847	0.935	0.743	-0.125	0.973	1.000		
X_8	0.802	0.960	0.986	0.879	0.155	0.955	0.938	1.000	
X_9	-0.210	-0.537	-0.565	-0.295	0.107	-0.548	-0.506	-0.496	1.000

The correlation of foreign direct investment as a dependent variable with other independent variables is high with GDFC (.910) followed by GDS (.811) and GFCF (.802). It is moderately correlated with GNP (.767), GDP (.638), import (.556) and is negatively correlated with inflation (-.210) and export (-.342).

When gross domestic product is dependent variable, its correlation with independent variables is high with GNP (.977) followed by GFCF (.960), GDS (.912), import (.906) and is moderately correlated with GDFC (.847), export (.349) and negatively with Inflation (-.537).

The correlation of GNP per capita with other independent variables asserts that it is strongly correlated with GFCF (.980) followed by GDP (.977), GDS (.962), GDFC (.935), import (.853) and FDI (.767). It is less correlated with export (.349) and negatively with inflation (-.565).

When import is taken as dependent variable it is found that it is highly correlated with GDP (.906) followed by GFCF (.879), GNP per capita (.853) and GDS (827). It is mildly correlated with FDI (.556), export (.545) and is negatively correlated with inflation by (-.295). When export is dependent variables its correlation with independent variables is high with import (.545) followed by GDP (.349). It is moderately correlated with GFCF (.155), GNP (.148), inflation (.107) and negatively correlated with GDCF (-.125) and FDI (-.341).

The correlation of gross domestic saving among independent variables is found to be highly correlated with GDCF (.973) followed by GNP (.962), GFCF (.955) and GDP (.912). It is relatively less correlated with import (.827), FDI (.811), export (.061) and is negatively with inflation (-.548).

When gross domestic capital formation is taken as dependent variable it is observed that it is strongly correlated with GDS (.973)

followed by GNP (.935), GFCF (.938), and FDI (.910). It is mildly correlated with GDP (.847), import (.743) and is negatively correlated with export (-.125) and inflation with (.506).

When gross fixed capital formation is dependent variable its correlation with independent variables is high with GNP (.986) followed by GDP (.960), GDS (.955) and GDCF (.938). It is less correlated with import (.879), FDI (.802), export (.155) and is negatively correlated with inflation (.496).

When inflation is taken as dependent variable its correlation with independent variables is moderate with export (.107) and negative with FDI (-.210), import (-.295), GFCF (-.496), GDCF. (-.506), GDS (-.548), GNP (-.565) and GDP (-.537).

5.4.3 Inter-relationship among Independent Variables in Thailand

The inter-relationship among independent variables has been determined by considering each variable once as dependent variables and then its relationship with other variables is correlated. The result thus, obtained are tabulated in Table 5.4.

Table 5.4
Correlation Coefficient Matrix for (of the independent variables) Thailand during 1990-2001

	X_1	X_2	X_3	X_4	X_5	X_6	X_7	X_8	X_9
X_1	1.000								
X_2	-0.199	1.000							
X_3	-0.248	0.967	1.000						
X_4	0.002	0.866	0.807	1.000					
X_5	0.466	0.170	0.096	0.575	1.000				
X_6	-0.334	0.940	0.934	0.675	-0.168	1.000			
X_7	-0.628	0.760	0.796	0.467	0.440	0.833	1.000		
X_8	-0.612	0.791	0.824	0.475	0.403	0.870	0.993	1.000	
X_9	0.045	0.120	0.216	-0.192	-0.466	0.312	0.169	0.406	1.000

The correlation of foreign direct investment with other variables indicates that it is highly correlated with export (.466) followed by import with (.022). It is negatively correlated with GDP (-.199), GNP per capita (-.248), GDS (-.334), GDFC (-.612) and GDCF with (-.628).

When gross domestic product is taken as dependent variable its correlation with other independent variable is strong with GNP (.967) followed by GDS (.940) and import (.866). It is moderately correlated with GFCF (.791), GDCF (.760), export (.170), inflation (.120) and is negatively correlated with FDI (-.199).

The assessment of GNP per capita as dependent variable reveals highest correlation with GDP (.967) followed by GDS (.934), GFCF (.824) and import with (.807). It is mildly correlated with GDCF with (.796), inflation with (.210), export with (.096) and is negatively correlated with FDI by (-.248).

The correlation of import with other independent variables asserts strong relationship with GDP (.866) followed by GNP per capita (.807), GDS (.675), export (.575). It is less correlated with GFCF (.475), GDCF (.467), FDI (.002) and is negatively correlated with inflation (-.192)

Taking exports as dependent variable reveals strong correlation with import (.575) followed by FDI (.466) and GDS (.675). It is moderately correlated with GDP with (.170), GNP per capita (.096) and is negatively correlated with GDS (-.168), GDCF (-.246), GFCF (-.266) and inflation with (-.466).

When gross domestic saving is taken as dependent variable its correlation with other independent variable is very high with GDP (.940) followed by GNP per capita (.934) and it is moderately correlated with GFCF (.870), GDCF (.833), import (.675), and inflation (.312). It is negatively correlated with export (-.168) and FDI with (-.334).

The correlation of gross domestic capital formation with other independent variables shows the strong correlation with GFCF (.993) followed by GDS (.833), GNP per capita (.796) and GDP (.760). It is moderately correlated with import (.467) inflation (.425) and negatively correlated with export (-.246) and with FDI (-.628).

When gross fixed capital formation is dependent variables its correlation is strong with GDCF (.993) followed by GDS (.870), GNP per capita (.824) and GDP (.791). It is moderately correlated with import (.475), inflation (.406) and is negatively correlated with FDI (-.612).

The correlation of inflation as dependent variables with other independent variables asserts that it is highly correlated with GDCF (.425) followed by GFCF (.406), GDS (.312). It is mildly correlated with GNP per capita (.216), GDP with (.120), FDI with (.045) and is negatively correlated with GNP (-.192) and export with (-.466).

5.4.4 Inter-relationship among Independent Variables in Singapore

For determining the inter-relationship among the independent variables each variable has once been considered as dependent variable and then its relationship with other variables is correlated. The results thus, obtained are tabulated in Table 5.5.

Table 5.5
Correlation Coefficient Matrix for (of the independent variables) Singapore during 1990-2001

	X_1	X_2	X_3	X_4	X_5	X_6	X_7	X_8	X_9
X_1	1.000								
X_2	0.672	1.000							
X_3	0.678	0.957	1.000						
X_4	0.646	0.979	0.966	1.000					
X_5	0.644	0.988	0.926	0.983	1.000				
X_6	0.649	0.967	0.959	0.943	0.938	1.000			
X_7	0.615	0.900	0.960	0.913	0.853	0.947	1.000		
X_8	0.658	0.941	0.968	0.911	0.844	0.966	0.963	1.000	
X_9	-0.403	-0.403	-0.558	-0.585	-0.683	-0.703	-0.514	-0.653	1.000

The correlation of foreign direct investment with other variables indicate that it is highly correlated with GNP per capita (.678) followed by GDP with (.672), GFCF with (.658), GDS with (.649), import (.646), export (.644) and GDCF with (.615). Whereas it is negatively correlated with inflation (-.403).

When gross domestic product is dependent variable its correlation with independent variables is high with export (.988) followed by import (.979), GDS (.967), GNP per capita (.957), GFCF (.941), GDCF (.900). It is moderately correlated with FDI (.672) and is negatively correlated with inflation (-.713).

Taking GNP per capita as dependent variable reveals reflects the strong correlation with GFCF (.968), followed by import (.966), GDCF (.960), GDS (.959), GDP (.957), export (.926). It is moderately correlated with FDI (.678) and negatively with inflation (-.558).

The dependent variable imports asserts the strong correlation with export (.983) followed by GDP (.979), GNP per capita (.966), GDS (.943), GDCF (.913) and GFCF (.911). It is mildly correlated with FDI (.644) and negatively with inflation (-.585).

When exports are dependent variable, its correlation with independent variable is high with GDP (.988), followed by import with (.983), GDS (.938) and GNP per capita (.926). It is moderately correlated with GFCF (.884), GDCF (.853), FDI (.644) and is negatively correlated with inflation with (-.683).

The correlation of gross domestic saving as a dependent variable reflects the strong correlation with GFCF (.966) followed by GDP (.967), GNP per capita (.959), GDCF (.947), imports (.943), exports (.938). It is mildly correlated with FDI (.649) and negatively with inflation (-.707).

The inter-relationship among independent variables by taking gross domestic capital formation as dependent variables reveals the strong correlation with GFCF (.963) followed by GNP per capita (.960), GDS (.947), import (.913) and GDP with (.900). It is moderately correlated with export (.853), FDI (.615) and negatively correlated with inflation (-.514).

When gross fixed capital formation is taken as dependent variable its correlation with other independent variables reveals the strong correlation with GNP per capita (.968) followed by GDS (.966), GDCF (.963), GDP (.941) and import (.911). It is mildly correlated with export (.884), FDI (.658) and negatively correlated with inflation (-.653).

The correlation of inflation with other independent variables asserts that it has a negative correlation with all the variables under consideration as FDI with (-.403), GDCF (-.514), GNP per capita (-.558, Import (.585), export, (-.683), GDS with (-.707) and GDP with (-.713).

5.4.5 Inter-relationship among Independent Variables in Malaysia

For determining the inter-relationship among the independent variables each variables has once been considered as dependent variable and then its relationship with other variables is correlated. The results thus, obtained are tabulated in Table 5.6

Table 5.6
Correlation Coefficient Matrix for (of the independent variables) Malaysia during 1990-2001

	X_1	X_2	X_3	X_4	X_5	X_6	X_7	X_8	X_9
X_1	1.000								
X_2	0.345	1.000							
X_3	0.612	0.928	1.000						
X_4	0.210	0.970	0.844	1.000					
X_5	-0.042	0.874	0.662	0.936	1.000				
X_6	0.230	0.966	0.844	0.959	0.943	1.000			
X_7	0.761	0.753	0.904	0.652	0.364	0.604	1.000		
X_8	0.754	0.752	0.908	0.640	0.352	0.598	0.997	1.000	
X_9	0.256	-0.467	-0.251	-0.536	-0.573	-0.455	-0.104	-0.091	1.000

The correlation of foreign direct investment with other variables indicates that it is highly correlated with GDCF (.761) followed by GFCF (.754) and GNP per capita (.612). It is moderately correlated with GDP (.345), inflation (.256), GDS (.230), import (.210) and negatively correlated with export (-.042).

When gross domestic product is taken as dependent variable its correlation with independent variables asserts that it is strongly correlated with import (.970) followed by GDS (.966) and GNP per capita with (.928). It is relatively less correlated with export (.874), GDCF (.753), GFCF (.752), FDI with (.345) and negatively correlated with inflation (-.467).

The dependent variables gross national product per capita reveals the strong correlation with GDP (.928) followed by GFCF (.908), GDCF (.904), GDS (.844), and import with (.844). It is moderately correlated with export (.662), FDI (.612) and negatively correlated with inflation (-.251).

When import is dependent variable its correlation is high with GDP (.970) followed by GDS (.959), GDCF (.652), GFCF (.640). It is mildly correlated with FDI (.210) and negatively correlated with inflation (-.536).

When export is taken as dependent variable it is found that its correlation among independent variable is high with GDS (.943) followed by import (.936) and GDP with (.874). It is mildly correlated with GNP

per capita with (.662), GDCF (.364), GFCF (.352) and negatively correlated with FDI (-.042) and inflation by (-.573).

The correlation of gross domestic saving with other independent variable is high with GDP (.966) followed by import (.959), export (.943) and GNP per capita (.844). It is found to be relatively less correlated with GDCF (.604), GFCF (.598), FDI (.230) and negatively correlated with inflation (-.455).

Taking gross domestic capital formation as dependent variable reveals that it is strongly correlated with GFCF (.997) followed by GNP per capita (.904), FDI (.761) and GDP with (.753). It is moderately correlated with import (.652), GDS (.604), export (.364) and is negatively correlated with inflation (-.101).

When gross fixed capital formation is taken as dependent variable its correlation with other independent variable reveals strongly correlation with GDCF (.997) followed by GNP per capita (.908), FDI (.754) and GDP (.752). It is moderately correlated with import (.640), GDS (.598), export (.352) and negative with inflation (-.091).

The correlation of inflation among the independent variables as a dependent variable asserts the weak position with FDI (.256) followed by negative correlation with GFCF (-.91), GDCF (-.104), GNP per capita (-.251), GDS with (-.455), GDP with (-.467) and export with (-.573).

5.4.6 Inter-relationship among Independent Variables in India

The inter - relationship among the independent variables is determined by considering each variable once as dependent variable and

then its relationship with other variables is correlated. The results thus obtained are tabulated in Table 5.7

Table 5.7
Correlation Coefficient Matrix for (of the independent variables) India during 1990-2001

	X_1	X_2	X_3	X_4	X_5	X_6	X7	X_8	X_9
X_1	1.000								
X_2	0869	1.000							
X_3	0.893	0.988	1.000						
X_4	0.879	0.988	0.974	1.000					
X_5	0.908	0.956	0.949	0.979	1.000				
X_6	0.598	0.805	0.776	0.841	0.836	1.000			
X_7	0.847	0.956	0.961	0.945	0.923	0.803	1.000		
X_8	0.891	0.978	0.982	0.976	0.962	0.809	0.985	1.000	
X_9	-0.538	-0.644	-0.632	-0.677	-0.723	-0.661	-0.625	-0.631	1.000

The correlation of FDI with other variables indicates that it is highly correlated with exports (.908) followed by GNP per capita with (.893), GFCF with (.891), import with (.879), GDP (.869), and GDCF (.847). It is found to be relatively less correlated with GDS (.598) and is negatively correlated with (-.538).

When gross domestic product is considered as dependent variable among the set of independent variables it asserts that it is highly correlated with import (.988), GNP per capita (.988) followed by GFCF (.978) and GDCF (.956). It is mildly correlated with FDI (.869), GDS (.805) and negatively correlated with inflation (-.644).

The relationship among independent variables when GNP per capita is taken as dependent variable reveals that it is strongly correlated with GDP (.988) followed by GFCF (.982), import (.974), GDCF (.961) and export (.949). It is somewhat less correlated with FDI (.893) and negatively correlated with inflation (-.632).

Taking import as a dependent variable its correlation with independent variables is high with GDP (.988) followed by export (.979), GFCF (.976), GNP per capita (.974) and GDCF (.945). It is mildly correlated with FDI (.879), GDS (.841) and negatively correlated with inflation (-.677).

When export is taken as dependent variable its correlation with independent variable is high with import (.979) followed by GFCF (.962), GDP (.956), GNP per capita (.949), GDCF (.923) and FDI (.908). It is relatively less correlated with GDS (.836) and negatively with inflation (-.723).

By considering gross domestic saving as dependent variable its relationship among other independent variables indicates that it is highly correlated with import (.841) followed by export (.836), GFCF (.809), GDP (.805) and GDCF (.803). It is moderately less correlated with GNP per capita (.776), FDI (.598) and negatively correlated with inflation (-.661).

The correlation of gross domestic capital formation as dependent variable with other independent variable asserts that it is highly correlated with GFCF (.985) followed by GNP per capita (.961), GDP (.956), import with (.945), export with (.923). It is mildly correlated with FDI (.847), GDS (.803) and is negatively correlated with inflation (-.625).

The relationship of gross fixed capital formation as a dependent variable among the set of the independent variables reflects the strong correlation with GDCF (.985) followed by GNP per capita (.982), GDP (.978), import (.976), export (.962). It is moderately correlated with FDI (.891), GDS (.809) and negatively correlated with inflation (-.631).

When inflation is taken as dependent variable its relationship with other independent variable indicates that it is negatively correlated with

FDI (.538) followed by GDCF (.625), GFCF (.631), GNP per capita (-.632), GDP with (-.644), GDS with (-.661) import (.677) and finally with export (-.723).

5.5 FACTOR ANALYSIS

Factor analysis is considered to be a sound technique in assessing the effectiveness of various macroeconomic variables in building strong economic pretence in a country. It attempts to assess the values of regression coefficients where the original values are regressed on the factors. The coefficient of regression is termed as factor loading. Factor loading gives a set of nine factors loadings, which is further processed by rotation.

Table 5.8
Variables Selected for Calculating Relationship Between FDI and Macroeconomic Indicators

VARIABLES	DESCRIPTION
X_1	Foreign Direct Investment (FDI) Inflows
X_2	Gross Domestic Product (GDP)
X_3	Gross National Product (GNP) Per capita
X_4	Import on c.i.f basis
X_5	Export on f.o.b basis
X_6	Gross Domestic Saving (GDS)
X_7	Gross Domestic Capital Formation (GDCF)
X_8	Gross Fixed Capital Formation (GFCF)
X_9	Inflation

In the present analysis the set of nine variables as presented in the above table are considered to be the most suitable indices for the sound economic environment are collapsed into each other and are rotated further to form precise and new variables for strong macroeconomic set up in a country.

The analysis is carried out for the period 1990-2001. The correlation has been done through factor analysis package programme on commuter SPSS-11 system. The value of the nine variables have been computed for six countries resulting in a 9 x 9 data matrix for the study region.

China; Factor 1

The analysis of the variables during the period 1990-2001 indicates that 87.04 per cent of the total variance is explained by one factor (Table 5.8)

Table 5.9
Factor Structure of Macroeconomic Variables and Foreign Direct Investment Flows in China through Rotated Factor Matrix During 1990-2001

VARIABLES	FACTOR LOADING
X_1	.905
X_2	.996
X_3	.989
X_4	.965
X_5	.981
X_6	.995
X_7	.993
X_8	.996
X_9	-.428
Variance explained in Per cent	87.043
Cumulative Percentage of Variation explained	87.043

The above table reveals that the highest positive loading is shown equally by gross domestic product and gross fixed capital formation with (.996). This has been found to be closely associated with gross domestic saving with (.995) followed by gross domestic capital formation (.993), GNP per capita with (.989), export (.981), import (.965) and FDI (.905), where as the negative loading is shown by inflation with (-.428).

The above table signifies the fact that strong macroeconomic position of a country is the result of the combination of many factors effecting each other. Likewise, the close association of gross domestic product and gross fixed capital formation all the other variables are also strongly correlated and simultaneously contributed in a way for sound macroeconomic setup.

Indonesia; Factor 1

The analysis of the variables during the period 1990-2001 asserts that 89.09 per cent of the total variance is explained by two factor (Table 5.10). Factor 1, explains 72.09 per cent of total variation. The variables which shows highest loading includes GNP per capita (.992) followed by gross fixed capital formation (.991). This has been associated with gross domestic saving (.982), GDP (.960) gross domestic capital formation (.959), import (.873) and FDI with (.800). The variables having low loading is export (.131), whereas the variable inflation is having negative loading by (-.547).

Table 5.10
Factor Structure of Macroeconomic Variables and Foreign Direct Investment Flows in Indonesia Through Rotated Factor Matrix During 1990-2001

VARIABLES	FACTOR LOADING	
	F1	F2
X_1	0.800	-0.453
X_2	0.960	0.227
X_3	0.992	2.059
X_4	0.873	0.437
X_5	0.131	0.990
X_6	0.982	-7.314
X_7	0.959	-0.256
X_8	0.991	2.746
X_9	-0.547	0.178
Variance explained in Per cent	72.089	17.004
Cumulative Percentage of Variation explained	72.089	89.092

The above values reveals that these variables are closely related as GNP provides the base for other variables to become stronger. The saving rate is also influenced by influx of FDI and strong income entity etc.

Factor II

It account for 17.00 per cent of the total variance and is strongly loaded on about thirty four per cent of the variable. The rotated factor shows highest positive loading by gross fixed capital formation with (2.746) followed by GNP per capita (2.06), export (.990). The variables having moderate loading includes import (.437), GDP (.227), inflation (.178) and the variables having negative loading includes gross fixed capital formation (-.256) and FDI with (-.453).

Thailand; Factor 1

The analysis of the variable for the period 1990-2001 indicates that 94.80 per cent of the total variance is explained by three factors (table 5.11). Factor 1, explains the 58.53 per cent of the total variation. The highest positive loading is shown by gross domestic saving (.961), GNP per capita (.952), gross fixed capital formation (.940) and GDP with (.938). These variables are closely associated and are helpful for the other macroeconomic variables to grow properly. The variables, which have negative loading, include (FDI (-.452) and export (-.789).

Table 5.11
Factor Structure of Macroeconomic Variables and Foreign Direct Investment Flows in Thailand Through Rotated Factor Matrix During 1990-2001

VARIABLES	FACTOR LOADING		
	F1	*F2*	F3
X_1	-0.452	0.519	0.703
X_2	0.938	0.310	6.095
X_3	0.952	0.215	9.294
X_4	0.705	0.689	-3.661
X_5	7.890	0.924	1.560
X_6	0.961	2.632	0.100
X_7	0.930	-0.273	-6.551
X_8	0.940	-0.263	-5.999
X_9	0.300	-0.565	0.731
Variance explained in Percentage	.58.535	24.479	11.783
Cumulative Percentage of Variation explained	58.014	83.014	94.798

Factor II

It account for 24.48 per cent of the total variance and is strongly loaded on about 49 per cent of the total variance. The rotated factor

shows highest positive loading by export (.924), followed by import (.968), FDI (.519), GDP (.310) and GNP per capita with (.215). This reflects that export is being made on larger basis accompanied by FDI and GDP growth rate. The variables, which have negative loading, include gross fixed capital formation (-.263), gross domestic saving (2.662) and gross domestic capital formation with (.273). This can evidently be supported from the above revealed truth that country is making progress on the basis of export with close association with imports, FDI flows and GDP growth rate.

Factor III

It account for 11.78 per cent of the total variance and is strongly loaded on about 24 per cent of the variance. The rotated factor shows highest loading by GNP per capita (9.294) which is closely associated with GDP (6.095) followed by inflation (.731), FDI (.703), exports (1.560) and gross domestic savings by (.100). This fact presents some mix results and reveals that growth rate of GNP per capita is accompanied by GDP growth and the growth rate of other variables. The variables, which have negative loading, include import (-3.661), gross fixed capital formation and gross domestic capital formation with (-6.551). This can be stated on the basis of the above mentioned evidence that the economy can make progress even if it has some insufficient parameters.

Singapore; Factor I

The analysis of the variables during the period 1990-2001 asserts that 84.36 per cent of the total variance is explained by one factor (Table 5.12). It asserts that the highest positive loading is shown by GDP (.990), followed by gross domestic saving (.985), GNP per capita (.976), imports (.971), gross fixed capital formation with (.970) and gross domestic

capital formation (.940) and FDI with (.715). The above truth reveals strong macroeconomic position where the entire variable is closely associated with each other. The negative loading as shown by inflation (-.965) signifies that some times it is even necessary for an economy to grow.

Table 5.12
Factor Structure of Macroeconomic Variables and Foreign Direct Investment Flows in Singapore Through Rotated Factor Matrix During 1990-2001

VARIABLES	FACTOR LOADING
	F1
X_1	0.715
X_2	0.990
X_3	0.976
X_4	0.971
X_5	0.964
X_6	0.985
X_7	0.940
X_8	0.970
X_9	-0.695
Variance explained in Percentage	84.362
Cumulative Percentage of Variance explained	84.362

Malaysia; Factor 1

The analysis of the variables for the period 1990-2001 asserts that 91.26 per cent of the total variation is explained by two factors (Table 5.13). Factor 1, explains 67.94 per cent of the total variance. The highest positive loading is shown by GDP (.984), which is closely associated with GNP per capita (.967). This has been followed by imports (.942), gross domestic saving (.926), gross domestic capital formation (.851) and

gross fixed capital formation (.841). The negative loading is being shown by inflation (-.415).

This can be stated from the above evidence that GDP growth rate associated with other variables is helpful in moving towards making economic goals success. However, FDI position with (.492) is rather mild.

Table 5.13
Factor Structure of Macroeconomic Variables and Foreign Direct Investment Flows in Malaysia Through Rotated Factor Matrix During 1990-2001

VARIABLES	FACTOR LOADING	
	F1	F2
X_1	0.485	0.800
X_2	0.984	-0.147
X_3	0.967	0.197
X_4	0.942	-0.295
X_5	0.797	-0.553
X_6	0.926	-0.284
X_7	0.846	0.486
X_8	0.814	0.493
X_9	-0.415	0.667
Variance explained in Percentage	67.944	23.312
Cumulative Percentage of Variance explain	67.944	91.256

Factor II

It account for 23.31 per cent of the total variance and is strongly loaded on about forty six per cent pf the total variable. The rotated factor shows highest positive loading FDI (.800) which is closely associated with inflation (.667), gross fixed capital formation (.493), gross domestic capital formation (.486) and GNP per capita (.197). The above truth

reveals the fact that FDI accompanied by inflation and capital formation even in the presence of some negative loading as shown by GDP (-.147), gross domestic saving (-.284), import (-.295) and export (-.553) is taking ahead the economy towards economic progress.

India; Factor 1

The analysis of the variable for the year 1990-2001 indicates that 86.87 per cent of the total variance is explained by one factor (Table 5.14).

Table 5.14
Factor Structure of Macroeconomic Variables and Foreign Direct Investment Flows in India Through Rotated Factor Matrix During 1990-2001

VARIABLES	FACTOR LOADING
	F1
X_1	0.893
X_2	0.983
X_3	0.979
X_4	0.990
X_5	0.986
X_6	0.849
X_7	0.960
X_8	0.986
X_9	-0.719
Variance explained in Percentage	86.866
Cumulative Percentage of Variation explained	86.866

The highest positive loading is shown by export with (.986) followed by import (.990), GDP (.983), GNP per capita (.983) and gross domestic capital formation (.966). This has been closely associated with FDI (.893) and gross domestic saving (.849). It can be asserted on the basis of above mentioned evidence that with the availability of sound

macroeconomic variables a country even in the presence of negative influence as shown by inflation (-.719) can make its lead towards economic well being

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5.6 AN ASSESSMENT OF THE ECONOMIC IMPACT OF FDI FLOWS IN SELECTED ASIAN COUNTRIES

After analysing the inter-relationship among the set of explanatory variables and the inter-weitage comparisons through factor analysis, we have approached the inter country comparisons of FDI impact for the selected Asian countries during the period 1990-2001.

The impact of FDI flows in selected Asian countries has been assessed by correlation coefficient between FDI and macroeconomic variables. The present analysis deals with the countries namely China, Indonesia, Thailand, Singapore, Malaysia and India.

Table 5.15
Correlation Coefficient Between Foreign Direct Investment Inflows and Macroeconomic Variables in Selected Asian Countries During 1990-2001

	X_1andX_2	X_1andX_3	X_1andX_4	X_1andX_5	X_1andX_6	X_1andX_7	X_1andX_8	X_1andX_9
China	0.890	0.881	0.843	0.853	0.922	0.931	0.986	-0.092
Indonesia	0.638	0.767	0.556	-0.340	0.811	0.910	0.802	-0.210
Thailand	-0.199	-0.248	0.002	0.466	-0.334	-0.628	-0.621	0.045
Singapore	0.672	0.678	0.646	0.644	0.649	0.615	0.658	-0.403
Malaysia	0.345	0.612	0.210	-0.042	0.230	0.761	0.754	0.256
India	0.869	0.893	0.879	0.908	0.598	0.847	0.891	-0.538

The correlation coefficient between FDI and GDP that is growth rate of GDP with FDI flows has been found to be strong in China (.890),

followed by India (.869), Singapore (.672), Indonesia (.638) and Malaysia (.345). The negative correlation is found in the case of Thailand (-.199).

When FDI and GNP per capita correlation coefficient is undertaken, it is observed that India stands at high position with (.893) followed by China (.881), Indonesia (.707), Singapore (.678) and for Malaysia it stand at (.612). Again the FDI and GNP per capita are found to be negatively correlated for Thailand (-.210).

Taking the correlation coefficient between FDI and export meaning thereby growth of exports associated with FDI inflows has been again found to be strong for India with (.908) followed by China with (.853), Singapore (.644) and for Thailand it stands at (.466). The correlation coefficient for the FDI and export is found to be negatively correlated for Malaysia (-.042) and for Indonesia it stands at (-.340).

The correlation coefficient between FDI and gross domestic saving is high in China (.922) followed by Indonesia (.811) and Singapore with (.649). The relationship is rather moderate for India with (.459), Malaysia (.230), whereas it is negative for Thailand by (-.334).

The assessment of the relationship between FDI and gross domestic capital formation found to be strong for China with (.931) followed by Indonesia (.910), India (.847), Malaysia (.761) and Singapore (.615). This is found to be negative for Thailand (-.628).

The relationship between FDI and gross fixed capital formation is high for China with (.986) followed by India (.891), Indonesia (.802), Malaysia (.754) and for Singapore it stands at (.658). The relationship is found to be negatively correlated for Thailand with (-.612).

The correlation coefficient between FDI and inflation is rather mild in Malaysia (.256) followed by Thailand with (.045). This relationship is

found to be negatively correlated for China with (-.092), Indonesia (-.210), Singapore (-.403) and for India it stands at (.538).

The high correlation between FDI and the set of other explanatory variables for the respective countries is found for gross fixed capital formation (.931) in China, for gross domestic capital formation (.910) in Indonesia, for export (.466) in Thailand, for GNP per capita (.670) in Singapore, for gross domestic capital formation (.761) in Malaysia and for export (.908) in India.

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CHAPTER-6

CONCLUSIONS AND SUGGESTIONS

6.1 CONCLUSIONS

FDI has played a significant role in the growth and development of the world economy particularly the developing countries. This prospect has brought the emergence of a more liberal policy towards foreign capital. It has turned the attitudes of developing countries towards newer roles of foreign capital in order to access superior technology, managerial skills and marketing channels in addition to the more traditional roles of relaxing the domestic savings and foreign exchange. The developing countries due to their low income, capital accumulation, machinery and equipment, expertise with a bulk of untapped natural as well as human resources take FDI not only as a means to supplement the financial and technical needs but also for export complacency, developing the domestic market, structural changes and supplementing the countries' purchasing power. These prospects have also changed the attitudes of the developing countries to reap the benefits of capital inflows on employment, workers training and technological transfer effects etc.

The 1990s, universal phenomena of liberalization, privatization and globalization have compelled a large number of developing and Central and East European countries to adopt more liberal policies. FDI policies along with trade policies have infact become the focus of liberalization efforts in almost every country. The inflow of FDI has increased in the developing countries during 1990s, and has been concentrated in the middle-income countries. The other form of foreign capital namely, concessional loans and foreign aid has declined in real terms.

The growing importance of FDI and its effectiveness has led to the development of a number of theories which explains why MNCs indulge in FDI, why they choose one country in preference to another to locate

their foreign business activity and why they choose a particular entry mode. These theories have also tried to explain why some countries are more successful than others in obtaining FDI.

FDI contributes to the growth of developing economies through physical capital formation, including technology transfer, human capital (management skills) development and promotion of foreign trade. The foreign owned firms stimulate local productivity through backward linkages to service supplies and the labour force by serving as a model of working practices and management techniques. The role of FDI in developing countries has increased sharply in past ten years because of higher returns, risk diversification, financial deregulation, advance technology and the availability of diverse financial instruments.

This has brought the emergence of more liberal attitude towards foreign capital, which is reflected from the fact that the number of countries that have changed their investment regimes have increased from a mere 35 in 1991 to as many as 71 in 2001. The number of regulatory changes introduced by different countries of the world has also increased from 82 in 1991 to 208 in 2001. The Asian and Pacific region introduced the largest number of such changes. This includes the fiscal adjustment programmes, trade liberalization and financial sector liberalization, which have promoted more private sector activity and outward oriented economies. There was a shift from the inward oriented FDI in the late 1970s, towards export oriented FDI during 1990s. The other feature of FDI inflows is that it has been shifted from manufacturing and extraction to services, particularly in the new capital intensive services, namely transportation, banking and public utilities, which are being privatized and opened to FDI in several developing countries.

There has been a sharp increase in the pattern of foreign investment in the NIEs and ASEAN countries. The liberalization of domestic trade policies in the presence of currency realignment and trade policy restrictions resulted in more FDI flows. Since early 1990s, developing countries realized a decline in inflation, higher growth of output and exports, higher and more productive investments and the reduction of external liabilities have reflected good prospects for foreign investors. Many of these countries have also realised a significant growth in the skilled labour force and improvements in supporting infrastructure.

The distribution of FDI flows to developing countries has favoured Asian region economies as compared to the Latin American and the Caribbean economies. The recent FDI flow show that the region is further building its lead. This is reflected in developing Asia's continued performances, growing market size, profitable investment opportunities among the developing country regions in terms of GDP and export growth rates etc. This has made developing Asia particularly, the East and South-East Asian region as the largest recipient of FDI among the developing countries, where the substantial amount of FDI is interregional. The concentration of FDI flows in these countries has resulted also due to (a) minimum risk and better prospects in these countries (b) low production costs associated with higher productivity (c) the appreciation of other respective currencies (d) infrastructure improvements and technology upgradation in ASEAN countries and (e) market externalities in other developing countries and market growth realized by the several countries of the region. Moreover, the opening up of certain sectors, particularly in services and the relaxation of rules regarding ownership, entry and financing along with the long-term prospects of these economies contributed in these flows. The inflows of

FDI to the developing countries in 2001 was US $204801 million in which US $10266 million (27.9 per cent) went to developing Asia and US $46840 million gone to China alone. Latin America and the Caribbean received US $85373 million (11.6 per cent) in the year 2001. The countries of the Central and Eastern Europe still in transition to a market economy attracted US $27200 million (merely 3.7 per cent) of the total FDI flows in the year 2001.

FDI affects capital formation largely in the form of green field investment rather than that of the merger and acquisitions. This depends to a large extent on the competitive advantage and also on domestic economic policy. FDI not only fill-up the saving – investment gap but also meet the foreign exchange demand which arises on account of the country's import of goods and services, investment in foreign countries and other types of payment on the BOP account. Thus, FDI flows provides useful supplement to domestic investment with the ratio of inward FDI flows to gross fixed capital formation ranging from 10.5 per cent in China to 10.8 per cent in Indonesia, 14.4 per cent in Thailand, 43.8 per cent in Singapore and only 3.2 per cent in India during the year 2001.

Although, FDI brings financial and physical capital but, it's effect can be categorized as economic, social and political. The political aspects includes the question of national sovereignty due to the creation of enclaves and foreign elite in the host country, especially when there exists a significant economic, social and cultural difference between the investing and the host country. The economic aspects of FDI involves the micro and macro ones, which are associated with growth, output, employment, technological know-how, training of labours and inter industry linkages and the attraction of new industries. The micro

influences of FDI are related to structural changes in the economic and industrial organization, which also entails the danger of monopolistic and oligopolistic elements in the host economy.

China has started opening her economy in late 1978, and since then it has realized a major structural changes resulting in rapid economic growth and improvements in the living standards of its people even in the face of challenging political, social, and economic conditions.

The presence of large skilled labour force at competitive costs, growing market size, supporting infrastructure, political stability and effective policy factors have contributed much in attracting bulk of FDI. The preference for FDI in manufacturing sector along with accelerating FDI inflows especially from East and South-East Asia has made China as one of the fastest growing economies on the globe. China's success in attracting larger volume of FDI has been also due to the highly decentralized system of administration, which gives most of the decision making power to local authorities. After following the open door policy measures in 1979, FDI flows has been considerably increased in China and in the year 2001, China's attraction of FDI continued to stay at a relatively higher level. The amount of FDI flows has been increased from US $3709 million in 1987 to US $6596.1 million in the year 1990. This has been further increased from US $11976.8 million in 1991 to US $69194.6 million in the year 2001.

FDI has played an important role in the industrialization of Indonesian economy. After the adoption of economic reforms in the presence of high rates of inflation, low level of trade, badly damaged economic and physical infrastructure in 1967, Indonesia has undergone through the usual stages of industrialization by moving from import substitutions in intermediate and capital goods towards export oriented

goods. Since oil is very important in Indonesian economy, changes in oil prices have played a key role in stimulating these structural changes. As a result of such measures FDI flows has increased tremendously from US $10466.1 million in 1992 to US $33,816.1 million in 1997 and only to US $15043.4 million in the year 2001.

FDI has played a crucial role in the development of the Thailand economy, which has transferred it from basically a primary producer to manufacturing goods producer. It was primarily an agricultural economy, and its share to GDP continually declined and that of manufacturing sector increased over the yeas. Today's Thailand is considered as the most attractive investment location in South-East Asia and is widely known to become the fifth tiger of Asian NIEs. Its political stability, private entrepreneurship, cheap labour, positive attitude towards foreign investment and financial policies have contributed to this image, despite continuing problems with inadequate physical infrastructure and inefficient public bureaucracy. Since 1960, the government has brought new investment measures to attract foreign investment, which enabled Thailand's as one of the highly attractive countries among the developing economies. The amount of FDI has been increased from US $557.5 million in 1990 to US $8609.9 million in the year 2001.

The economy of Singapore is one of the most open and dynamic in the third world. Foreign investment has played a major role in the economic development of Singapore as an entrepot for the entire South-East Asian region. The rapid growth of Singapore economy has been the result of the combination of private investment, domestic and foreign and the active participation of the state in the economy. The liberal policy framework and greater competitiveness of the foreign firms in the export market made Singapore as the most heavily foreign dominated

manufacturing sector in the world. Since the initiation of reform measures in 1959, government has brought various measures to attract more FDI flows. The guidelines and regulations governing foreign investment in conformity with the countries development priorities and over all socio-economic objectives were brought up over the years. The amount of FDI has been increased from US $5575.0 million in 1990 to US $8609 million in the year 2001.

FDI has played a significant role in the transformation of Malaysia from an agricultural economy to an industrialized economy. After the inception of independence in 1957, Malaysia gone along cautious promotion strategy to a free enterprise economy. It has favoured FDI in tariff protected, import substituting manufacturing as well as in export-oriented agriculture. The numerous fiscal and other incentives were offered to both foreign and private investors. The guidelines and regulations governing foreign investment in conformity with the countries development priorities and overall socio-economic objectives were brought up. As a result of these measures, the amount of FDI has been increased from US $2562.0 million in 1990 to US $3759.0 million in the year 2001.

Since independence, the Indian governments policy towards FDI or foreign collaborations have evolved from cautious promotions in the late 1940s to a brief period of new "open door" in the 1950s to a policy of rigorous selectivity in the late 1960s and 1970s and to a policy of increasing liberalization in the 1980s to 1990s. These policies outline the broader economic development priorities and the objectives of the government. The announcement of the NEP measures on 24 July 1991 is said to have began the real reforms in the Indian economy. This has provided a fairly liberalized policy framework to attract FDI in India,

which were competent with those of several other Asian countries. Although, these policies resulted in impressive growth in the magnitude of FDI flows, but they are not able to fulfill the objectives of the NEP measures. These policies enabled the country to widen the sectoral as well as source country composition of FDI flows. The amount of FDI has increased from US $79 million in 1980 to US $237 million in 1990. It has further increased from US $117.1 million in 1991 to a peak of US $4522.6 million in 1997 and to US $4082.8 million in the year 2001.

Asian economies are among the fastest growing economies in the world, which is evident from the realization of sound macroeconomic variables. FDI has played a major role in the growth and development of Asian economies. Among them, South-East Asia and the ASEAN countries have realized a high growth rate of their economies. These prospects have brought the more liberal policy framework, a host of incentives with several bilateral and multilateral treaty agreements among these countries.

The share of Asian developing countries in attracting FDI in the world economy has increased but its share in developing countries has decreased. Among the South-East Asian region economies, FDI have sharply declined for Indonesia, and Malaysia has also experienced a downward trend. The Republic of Korea too has experienced a decline in the volume of FDI flows.

FDI flows in Asia has shifted from NIEs to ASEAN and further to China due to rising wages and currency appreciation in other countries. FDI flows in the Asia and the pacific is characterized by a decline in interregional investment, due to the financial and other difficulties faced by the regions TNCs. There is an increasing tendency of liberalization on the part of some countries to become regional investment hubs. The tax

incentives in China, Indonesia, Malaysia and Singapore consist of free import of capital equipment, tax holidays, accelerated depreciation, investment allowance, exemption from withholding taxes on dividends and interests rates etc. The vehicle for industrial restructuring in these countries has been FDI, where TNCs have acted as a catalyst for industrial restructuring and competitive regimes in the region.

FDI flows seem to be dependent on the sound infrastructural facilities as in the Guandong province of China, Judong in Singapore, and the Penang Peninsula in Malaysia. China's success in attracting large FDI flows also depends on the greater degree of decentralization of powers in the hands of the local authorities, whereas the centralized decision-making process in India creates cumbersome bureaucratic delays in the process of approval of FDI.

A common characteristic of the foreign investment policy of the countries studied is a remarkable degree of continuity. The existence of sound infrastructure facilities and favourable labour laws are the critical determinants of FDI flows into these countries. The activities of TNCs have been concentrated in a handful of host countries, namely the NIEs, a few countries in South – East Asia (Indonesia, Malaysia, Philippines and Thailand) and China, which altogether have attracted the large amount of bulk of FDI flows.

However, the effects of FDI flows on various macroeconomic variables has been found to be varying from country to country. For China, gross fixed capital formation is the major factor influenced by FDI flows. This factor has been followed by gross domestic capital formation and gross domestic saving. Similarly, the gross domestic capital formation along with gross domestic saving respectively is found to be effected by FDI flows in Indonesia. In Singapore, GNP per capita with

grows fixed capital formation and gross domestic saving is the major factor respectively influenced by FDI flows. For Malaysia, gross domestic capital formation along with gross fixed capital formation and GNP per capita respectively have been strongly correlated with FDI flows. Export along with GNP per capita and gross fixed capital formation respectively is found to be closely related with FDI flows in India.

Thus, Asian countries have realized a boom in the growth of investment, production and trade over the past few years and even there a double digit growth in China, parts of ASEAN and the Republic of Korea. This has resulted from an increased regionalization or globalization of production and the liberalization of investment and trade regimes within a framework of market oriented private sector growth. Japan, NIEs of Asia, Hong-Kong, Republic of Korea, Singapore, Taiwan and the ASEAN-4 (Indonesia, Malaysia, Philippines and Thailand), have realized rapid economic growth. The high economic growth in these economies have been characterized by changes in the structure of economic activity with manufacturing industries in particular becoming more important and the migration of production lines towards developing Asia. FDI by multinationals from USA, Japan, Europe and recently by the Asian NIEs and ASEAN-4 economies have played a crucial role in stimulating these growths.

FDI has played a significant role in promoting the economic growth of East and South-East Asian economies, through cost reduction and export promotion and by economic transformation of South-East Asian economies. Although, for some economists the role of FDI in economic development is still doubtful, but it can be said that if, it is properly utilized can contribute significantly to economic development.

This can be reflected from the performance of the South – East Asian economies, which are acknowledged to have absorbed a significant amount of FDI, though the primary growth impetus may have come from domestic efforts. Lastly, it may be said that the success of these countries in attracting FDI flows was in large part to the command nature of these economies, particularly Singapore and China, which allowed for quick changes in laws in responses to the emerging needs. This was infact, also true for Malaysia whereas, in India the ability to effect similar changes are limited.

6.2 SUGGESTIONS

FDI has gained importance globally as an instrument of international economic integration. The growing importance of FDI has brought up more open door policy measures with higher levels of efficiency and flexibility. The opening of markets to trade and FDI have created enlarged markets for final and intermediate goods and services and has provided TNCs and domestic firms with better access not only to national, regional but also to international markets. This has created a range of choices for TNCs regarding the modalities of serving these markets especially FDI, trade, licensing, sub-contracting, franchising and increased their access to immobile resources, low cost skilled labours, marketing expertise and improved the efficiency of their international production system. The extent and nature of FDI flows depends upon the precise combination of the economic opportunities available, the friendliness of the policy framework and the ease of doing business in the country.

The effectiveness of the FDI flows depend upon its meaningful use and its purpose, which require to focus and the identification of the

existing areas in which the injection of capital and know-how becomes fruitful. The inflow of FDI related with export-oriented areas, especially in medium and long term investment projects can fulfill the developmental needs of the country. This will give a boost to the better utilization of existing natural resources, manpower and creates an atmosphere conducive to providing efficient and cheap availability of superior goods and services. In the case of Indonesia as well as in Malaysia, the abundance of petroleum and other natural resources is important. The size of the domestic market in Indonesia, Philippines and Thailand and the favourable conditions for marketing in countries like Singapore, Hong Kong and South Korea are also presumably important in explaining the amount of FDI in a country.

The open door policy in China and India creates new opportunities of FDI from within and outside the region as both these continental economies have the potential for very big markets. China and India have liberalized their policies towards FDI mainly for technology acquisitions and marketing support provided by the foreign TNCs as these are essential for building up dynamic comparative advantage in the present day world. The growth prospects in ASEAN and Newly Industrialized Countries due to the absorption of the large amount of foreign direct investment can be even realized in various other countries. Similarly, the skills available at competitive cost in these countries and export processing activity which is currently in evidence in the ASEAN countries may gradually also emerge in other countries.

The following suggestions appear to be highly conducive for these countries to attract larger foreign direct investment.

(1) The distribution of FDI flows in the world economy is quite uneven as evident from the fact that the developed countries

receive most of the flows. This is not only associated with various policies governing FDI flows in these countries but a host of other factors including sound socio-economic set-up, effective macroeconomic variables, political stability and the good prospects available in these countries.

(2) FDI flows among the developing countries are concentrated in a handful of countries. The other countries are required to develop socio-economic overheads along with various policy measures. It is better to attract FDI in accordance with socio-economic requirements of the host country in such a way, which can pave the way for their future course of development. The proper steps should be taken to make macroeconomic conditions favorurable for the fast growth of FDI flows. Links to be established between foreign investors research and domestic industries through provision of tax credits and other services to facilitate technological partnership between domestic and foreign companies.

(3) The developing countries are required to adopt more reform measures, and to pursue such monetary and fiscal policies, which can be useful for strong economic buildup. These countries can carry long-term inter-country arrangements for FDI in order to develop socio-economic overheads in the presence of competitive costs. This applies particularly to small investors with limited resources who tend to have a preference for FDI in neighboring markets in order to keep transaction cost within manageable limits.

The developing countries due to untapped natural resources, low cost labours and other inputs can persuade multinationals to develop their countries as export platform. The maximum advantage can be taken by

developing even the Free Trade Zones (FTZs) and Economic Promotion Zones (EPZs) with attractive incentives. The other incentives include ownership rights, repatriation of profits, accelerated depreciation and investment allowance, exemption from income tax and / or capital gains tax under special conditions as well as exemption from paying withholding taxes or taxes on dividend and reduction of interest rates and fair compensation against nationalization etc.

Although these policy measures have brought FDI flows, but the full potential of FDI flows has not been realized. To attract more FDI flows, other substantial measures have to be taken. Attention has to be paid on the part of policy makers towards the development of human and technological resources in the country. The equity caps on imports, especially for the capital goods should have to be narrowed down. To attract more investments from foreign companies in the future it will be important to focus on small and medium size business and the investment in selected services sector, would add vitality to domestic business and domestic market. There is a need to encourage investment in basic/core sectors as against the consumer goods sector. Inspite of the difficulty of balance of payments, capital formation, debt and others, foreign direct investment should not be only taken as a source of filling the saving and investment gap but it should be provided wide coverage. FDI flows have to be encouraged in basic core sectors and should be directed towards creating domestic employment. These aspects of government policy may contribute to the perceived investment climate in the country including some elements of policy that apply to foreign enterprise such as performance requirements and fiscal incentives meant for industrial development.

Although, the developing countries have liberalized their economies but the pace of economic reforms have been slow and hesitant. The other measures, which have to be taken, include the simplification of investment approval process through the establishment of one-stop and the provision of information to companies regarding investment opportunities. These countries are required to adopt more substantial measures and have to ensure the continuity of the policy with a strong macroeconomic environment for attracting sufficient amount of FDI. FDI flows have also to be attracted by the probability of confidence in earning relatively higher profits.

In a changing world scenario, simply reform measures are not enough, there is a need to have a number of bilateral and regional, interregional and multilateral agreement such as dispute settlement provision, double taxation treaty agreements, protection and promotion of investment etc. Besides, there is also the need for an efficient investment promotion agency that can facilitate the entry and operations of foreign firms particularly for technologically dynamic firms that need to startup operations quickly in order to maintain their competitive edge. While allowing FDI the emphasis should be placed on green field investments rather than on mergers and acquisitions.

Furthermore, FDI regimes of several Asian countries need further improvements especially when compared with that of industrialized countries as well as non-Asian developing economies. It states that the effective national FDI policy framework requires a thorough understanding of the determinants, in particular the broader corporate strategies of TNCs and requires also the long-term improvement of the economic determinants of investment.

However, in an age in which FDI flows are becoming more global such measures have to be accompanied by clear and uniformly applied multilateral ground rules, which facilitate FDI. These economies are required to develop infrastructure facilities namely internal transport, communication, ports and airports etc. by diverting more domestic investments in to these areas if they are to make more effective use of FDI in to their economies. Moreover, for attracting more FDI flows, developing countries are required to have a combination of political stability, economic stability, prospects of market growth including labour laws, investment related laws and its transparency, infrastructural availability, production costs, skilled labour force, industrial regulations, facilitated access to government contracts, social institutions including educational and health policies.

Finally, the arrangements of the WTO agreements have to be fully implemented. Multilateral attention needs to be given to anti competitive practices especially for accessing foreign markets. A multilateral agreements carrying information on such practices would provide a dispute settlement system for settling differences can improve further international environment for FDI. UNCTAD as well as other international organizations can contribute through negotiations for FDI and by analyzing and consensus building, particularly with regard to developmental issues.

APPENDICES

APPENDIX-I

Macroeconomic Indicators of China During 1990-2001

Year/ Variable	FDI[a]	GDP[b]	GNP[c] Per Capita	IMPORT[d]	EXPORT[e]	GDS[f]	GDCF[g]	GFCF[h]	INFLATION[i]
1990	3.5	382.0	341.6	53.4	62.1	150.2	137.4	98.9	4.1
1991	4.4	399.8	353.5	63.8	71.9	159.2	141.2	111.6	3.4
1992	11.2	399.5	425.8	80.6	84.9	193.8	174.7	150.8	6.4
1993	27.5	598.8	509.0	103.1	91.0	250.8	260.3	225.3	14.7
1994	33.8	541.7	454.4	115.7	121.1	231.6	223.5	195.6	24.1
1995	35.9	700.6	688.5	129.1	148.8	297.5	285.9	243.1	17.1
1996	40.2	821.9	660.4	138.9	151.2	335.3	323.2	280.7	8.3
1997	44.2	903.5	717.3	142.2	182.9	372.5	343.3	303.4	2.8
1998	43.8	965.5	748.5	140.3	183.6	385.8	356.9	340.4	-0.8
1999	40.3	991.2	775.0	165.8	195.2	390.7	370.9	358.1	-1.4
2000	40.8	1080.0	843.6	206.1	249.3	420.2	389.6	394.1	0.4
2001	46.9	1191.5	986.2	243.6	266.1	445.9	439.5	444.8	0.7

Source: Key indicators of developing Asian and Pacific Countries, ADB, and International Financial Statistics, (Year Book), IMF, 2003.

Notes : a,b,d,e,f,g,h are expressed in US billion of dollars where d, is on f.o.b and e, is on c.i.f basis
c, is expressed in only US dollar and
i , represent the annual inflation rate.

APPENDIX-I
Macroeconomic Indicators of Indonesia During 1990-2001

Year/ Variable	FDI[a]	GDP[b]	GNP[c] Per Capita	IMPORT[d]	EXPORT[e]	GDS[f]	GDCF[g]	GFCF[h]	INFLATION[i]
1990	1.1	114.4	608.8	21.8	25.7	31.7	32.4	32.4	9.5
1991	1.5	128.2	670.0	25.9	29.1	42.9	41.0	36.0	9.3
1992	1.8	139.1	714.6	27.3	34.0	49.1	45.1	37.9	7.6
1993	2.0	158.0	803.6	28.3	36.8	51.3	46.6	41.5	9.7
1994	2.1	176.9	895.6	32.0	40.1	57.0	54.9	48.8	8.5
1995	4.4	202.1	1007.3	40.6	45.4	61.8	64.5	57.5	9.5
1996	6.2	227.4	1115.8	42.9	49.8	68.4	69.8	67.3	7.9
1997	4.7	215.8	1040.2	41.7	53.4	67.9	68.5	61.1	6.6
1998	-0.4	95.5	446.8	27.3	48.9	25.3	16.0	24.3	58.5
1999	-2.8	141.3	634.3	24.0	48.7	27.2	15.9	30.6	20.9
2000	-4.6	153.3	675.1	33.5	62.1	38.4	22.2	37.3	3.8
2001	-3.3	145.3	649.9	31.01	56.5	37.1	24.8	30.3	11.5

Source: Key indicators of developing Asian and Pacific Countries, ADB and International Financial Statistics, (Year Book), IMF, 2003.

Notes : a,b,d,e,f,g,h are expressed in US billion of dollars where d, is on f.o.b and e, is on c.i.f basis
c, is expressed in only US dollar and
i , represent the annual inflation rate.

APPENDIX-I
Macroeconomic Indicators of Thailand During 1990-2001

Year/ Variable	FDI[a]	GDP[b]	GNP[c] Per Capita	IMPORT[d]	EXPORT[e]	GDS[f]	GDCF[g]	GFCF[h]	INFLATION[i]
1990	2.6	85.3	1509.2	23.1	23.1	29.3	35.3	34.5	6.0
1991	2.0	98.2	1710.8	37.8	28.4	35.5	42.1	40.9	5.6
1992	2.1	110.9	1893.3	40.5	33.3	39.9	44.3	43.6	4.2
1993	1.8	124.2	1708.4	45.7	36.7	44.7	49.6	49.1	3.3
1994	1.4	144.5	2423.6	54.4	45.2	53.5	58.1	57.7	5.0
1995	2.1	168.3	2782.5	70.8	56.4	62.6	70.7	69.0	6.1
1996	2.3	182.4	2972.9	72.3	55.7	66.4	76.1	74.4	5.5
1997	3.6	151.1	2429.0	61.4	57.6	53.8	50.8	50.4	5.6
1998	5.1	111.9	1764.5	42.9	54.3	39.4	22.9	24.9	8.1
1999	3.5	122.1	1930.0	50.4	58.5	40.3	17.2	24.5	0.3
2000	2.8	122.2	1933.4	62.2	69.3	40.2	27.8	26.1	1.6
2001	3.8	115.3	1802.4	62.0	132.6	26.8	27.6	26.5	1.6

Source: Key indicators of developing Asian and Pacific Countries, ADB and International Financial Statistics, (Year Book), IMF, 2003.

Notes : a,b,d,e,f,g,h are expressed in US billion of dollars where d, is on f.o.b and e, is on c.i.f basis
c, is expressed in only US dollar and
i , represent the annual inflation rate..

APPENDIX-I

Macroeconomic Indicators of Singapore During 1990-2001

Year/ Variable	FDI[a]	GDP[b]	GNP[c] Per Capita	IMPORT[d]	EXPORT[e]	GDS[f]	GDCF[g]	GFCF[h]	INFLATION[i]
1990	5.6	36.7	12364.7	60.6	52.5	15.9	13.4	11.5	3.4
1991	4.9	42.8	13904.3	66.1	59.0	19.2	14.9	14.5	3.4
1992	2.2	49.1	15659.9	72.2	63.4	22.1	17.9	17.9	2.3
1993	4.9	57.6	17452.7	85.1	73.9	26.1	21.8	20.3	2.3
1994	8.5	69.8	20866.8	102.4	96.5	33.0	23.4	23.7	3.1
1995	8.8	83.4	24283.9	124.4	118.2	41.5	28.8	28.2	1.7
1996	8.6	91.3	25164.5	131.3	125.0	44.9	33.7	34.8	1.3
1997	10.8	94.6	26598.9	132.4	125.0	47.5	36.8	36.7	2.0
1998	6.4	82.7	21503.4	104.5	109.8	43.7	26.5	30.7	-0.3
1999	11.8	83.8	21051.3	111.0	114.6	40.8	26.4	27.6	0.1
2000	5.4	92.3	22752.9	134.7	138.0	44.0	29.5	27.3	1.3
2001	8.6	84.9	20892.5	115.9	121.7	32.8	20.8	25.0	1.0

Source: Key indicators of developing Asian and Pacific Countries, ADB and International Financial Statistics, (Year Book), IMF, 2003

Notes : a,b,d,e,f,g,h are expressed in US billion of dollars where d, is on f.o.b and e, is on c.i.f basis
c, is expressed in only US dollar and
i , represent the annual inflation rate.

APPENDIX-I

Macroeconomic Indicators of Malaysia During 1990-2001

Year/ Variable	FDI[a]	GDP[b]	GNP[c] Per Capita	IMPORT[d]	EXPORT[e]	GDS[f]	GDCF[g]	GFCF[h]	INFLATION[i]
1990	2.6	44.0	2373.5	29.3	29.5	15.2	14.3	14.6	3.1
1991	4.0	49.1	2515.6	36.7	34.4	16.8	18.6	17.9	4.3
1992	5.1	59.2	2941.4	39.8	40.7	21.7	20.9	21.7	4.7
1993	5.7	66.9	3255.9	45.6	47.1	26.2	26.2	26.0	3.5
1994	4.6	74.5	3525.5	59.4	58.6	29.5	30.7	30.0	3.7
1995	5.8	88.8	4093.2	77.6	73.9	35.3	38.8	38.7	3.4
1996	7.3	100.9	4542.3	78.4	78.3	43.2	41.8	42.9	3.5
1997	6.3	100.2	4375.8	78.5	78.5	44.0	43.1	43.4	2.7
1998	2.7	72.5	3139.9	58.2	73.1	35.1	19.3	19.4	5.3
1999	3.9	78.9	3508.7	65.0	84.5	37.5	17.7	17.5	2.8
2000	3.8	89.8	3386.1	82.2	98.1	42.4	24.4	22.9	1.5
2001	0.6	88.1	3391.8	73.9	88.0	37.2	21.9	21.9	1.4

Source: Key indicators of developing Asian and Pacific Countries, ADB and International Financial Statistics, (Year Book), IMF, 2003.

Notes : a,b,d,e,f,g,h are expressed in US billion of dollars where d, is on f.o.b and e, is on c.i.f basis
c, is expressed in only US dollar and
i , represent the annual inflation rate.

APPENDIX-I

Macroeconomic Indicators of India During 1990-2001

Year/ Variable	FDI[a]	GDP[b]	GNP[c] Per Capita	IMPORT[d]	EXPORT[e]	GDS[f]	GDCF[g]	GFCF[h]	INFLATION[i]
1990	0.2	324.9	361.0	23.7	17.9	72.4	77.2	70.8	12.0
1991	0.1	287.3	313.2	20.2	17.6	61.9	61.6	60.0	13.8
1992	0.3	288.4	308.2	23.6	19.6	80.1	65.5	61.2	11.8
1993	0.5	281.8	320.1	22.8	21.6	62.8	59.7	60.2	6.4
1994	1.0	321.9	361.4	26.8	25.0	80.2	75.9	70.9	10.2
1995	2.2	364.5	390.8	34.8	30.7	92.8	96.6	89.7	10.2
1996	2.5	384.4	407.1	37.9	33.1	89.4	85.5	88.0	9.0
1997	3.6	417.4	435.1	41.5	35.0	97.0	94.7	91.0	7.2
1998	2.6	426.2	430.9	43.0	33.4	91.4	90.2	90.7	13.2
1999	2.2	454.5	450.5	47.1	35.7	103.9	104.3	98.0	4.7
2000	2.3	468.2	459.8	51.6	42.4	168.7	106.4	103.3	4.0
2001	3.4	486.6	468.4	50.4	43.3	116.6	109.2	105.4	3.9

Source: Key indicators of developing Asian and Pacific Countries, ADB and International Financial Statistics, (Year Book), IMF, 2003.

Notes : a,b,d,e,f,g,h are expressed in US billion of dollars where d, is on f.o.b and e, is on c.i.f basis
c, is expressed in only US dollar and
i , represent the annual inflation rate.

APPENDIX – II

Exchange Rates of Various Currencies Per US Dollar During 1990 – 2001 (Average of Period)

(Per unit of Currency)

Year/Currency	China Yuan	Indonesia Rupiahs	Thailand Baht	Singapore Singapore Dollar	Malaysia Ringhit	India Rupees
1990	4.783	1842.8	25.585	1.813	2.705	17.504
1991	5.323	1950.3	25.517	1.728	2.750	22.742
1992	5.515	2029.9	25.400	1.629	2.547	25.918
1993	5.762	2087.1	25.320	1.616	2.574	30.493
1994	8.619	2160.8	25.150	1.527	2.624	31.374
1995	8.351	2,248.6	24.915	1.417	2.504	32.427
1996	8.314	2,342.3	25.343	1.410	2.516	35.433
1997	8.290	2,909.4	31.364	1.485	2.813	36.313
1998	8.279	10,1013.6	41.359	1.674	3.924	41.254
1999	8.280	7,855.2	37.814	1.695	3.800	43.055
2000	8.279	8,421.8	40.112	1.724	3.800	44.942
2001	8.277	10,260.9	44.432	1.791	2.800	47.186

Source: International Financial Statistics, (Year Book), IMF, 2003.

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